a changing Europe
The establishment of the European Bank was based on the commitment of its contracting parties to the fundamental principles of multiparty democracy, the rule of law, respect for human rights and market economics.

Its purpose 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 those same principles, thereby helping their economies to become fully integrated into the international economy.

The Bank focuses in particular on establishing the framework of a market economy, on creating modern financial and physical infrastructure, on strengthening financial institutions, on implementing restructuring and privatization, on developing the local private sector and on promoting environmentally sound and sustainable development in all of its operations. The projects it supports may involve one country or span several countries of the region.

The European Bank seeks to be a catalyst of change in its countries of operations. In playing that role, it encourages co-financing and foreign direct investment from the private and public sector, mobilizes domestic capital and provides technical assistance in relevant areas. The Bank applies sound banking principles to all its operations.
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Throughout the text, for reasons of consistency, non-ECU currencies have been converted into ECU on the basis of the conversion rates in force at 31 December 1991.

References to central and eastern Europe throughout the text include all the republics of the former Soviet Union, and references to the USSR or the Soviet Union as such are to be considered as valid until 31 December 1991.

Details of non-captioned photographs are provided on page 152.

* For consistency, the country reviews are presented in the same order in all language versions.

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a changing Europe
President’s statement

Since the European Bank was established, the geopolitical landscape of the continent has changed enormously: one member country, the German Democratic Republic, has united with another; a second member country, the Soviet Union, has ceased to exist and been replaced by fifteen others; a third, Yugoslavia, has seen the break-up of its federal system and recognition by many in the international community of several of its constituent republics, and Albania has rejoined the ranks of European democracies. Overall, the number of countries of operations of the Bank is in the process of expanding from eight to more than twenty.

In each of these new nations the euphoria that greeted the downfall of the totalitarian regimes has given way to the difficult task of implementing the rules of democracy, and the illusion of rapid economic reconstruction has vanished in the face of lasting recession, as severe as in western Europe between the two world wars.

Progress to date has been limited, because the legacy of the former totalitarian regimes has proved more pervasive than anticipated: parliamentary and legal institutions, banking systems, telecommunications, rail and energy networks, all have to be rebuilt. Each of these countries is trying to implement its own strategy to achieve the same goals; some governments have discovered that freeing prices does not in itself create businesses; others have learned that massive privatization cannot be effected only by decree. All of them now recognize that it will take time and substantial financial and operational help to rebuild their economies and develop their competitive sectors. A top priority will be for these countries to modernize their bureaucracies and indeed their entire state administration, in ways that ensure they are answerable to parliament. It will also be essential for them to establish fair and efficient systems to levy and collect taxes. Without such reform, these nations will have no possibility of developing into modern states.

The bulk of what needs to be done will rest on the shoulders of the citizens of these countries themselves, on their steadfast determination to establish the necessary institutions, on their ability to face up to challenging reappraisals. There is no doubt that their geography, history, culture and skills will help.
Of course, much will also depend on the extent to which the international community can marshal support; on its ability to see the value of financing the stabilization of a continent that has been unstable for a thousand years and to integrate 400 million people into the market economy. This will make it possible, on the one hand, to reduce the nuclear threat that hangs over the planet and to cut defence budgets and, on the other, to scale back agricultural subsidies and open up new markets. It is no exaggeration to state that, at the end of this century, global prosperity will largely depend on the success of this transition in Europe. International assistance must therefore be significant. It amounted to ECU 25 billion in 1991, taking into account debt rescheduling, and it will be on the same scale in 1992. These are large sums, but not enough.

The European Bank was created to complement the international response to these enormous needs. The idea of the Bank emerged at a time when the problems seemed to many far less serious than they have turned out to be; the Bank has now become an essential instrument in channelling international support, a catalyst and a partner for the business and banking community. It is a unique institution to deal with a unique situation. Not solely a development bank, or a merchant bank, or a consultative body, it is the only institution where, alongside the United States, Japan, Canada and others, practically all the countries of western, central, eastern and far eastern Europe are members on an equal footing. It is also the only institution entirely devoted to the success of transition both to democracy and to the market economy. The Bank can provide long term capital and invest in equity; it has specific mechanisms for financing infrastructure, privatization, enterprise, major networks, institutional reform and training centres. For all those involved in this formidable task, it is becoming a focal point for knowledge, experience and the exchange of ideas.

The idea of the Bank was first conceived in October 1989, before the Berlin Wall came down; it was inaugurated in April 1991 before the Moscow coup; and, in a matter of months, it has become fully operational. It has staff of close to 400 from almost all its member countries. Their average age of 36 is symbolic of the youth of the new Europe. The staff has experience in private and public sector financing and has specific skills in the financing of agriculture, energy, telecommunications, transportation, municipal development and financial services, as well as in the techniques of privatization and restructuring. It has developed environmental expertise and policies consistent with its founding Agreement. The Bank has selected its headquarters, and has established its name and its credit on capital markets with a triple A rating. Its first public ECU bond issue is considered a benchmark by the market.
The Bank has also committed almost ECU 500 million to sixteen projects up to the end of February 1992, which will attract close to a further ECU 2 billion from several banking and industrial partners. It has carried out these projects by developing high quality financing structures and operating according to international banking standards. We will continue to develop the syndication and co-financing capacity of the European Bank as a high priority in 1992 and have adapted our organization to this end. We have also provided technical assistance for close to one hundred projects and have begun to establish more than ten training centres, becoming a natural forum for government and corporate consultation.

In 1992, I hope that the Bank will more than double its activities, thanks to the work and support of all its members. The Bank will continue to help all its countries of operations to find the right paths of reform and approaches to transition, will continue to open resident offices in these countries, will enhance its relationship with the business community, and will finance as many projects as it can, consistent with its strategy and with sound banking principles. Priority will be given to those projects that help draw together the two parts of Europe such as transport, energy, telecommunications and those that promote the market economy. The Bank will continue to attach particular importance to concrete implementation of the projects it finances in each of these areas, closely allying a large part of its technical assistance to its projects to ensure that the specific skills required for implementation appear when and where they are needed.

The transition in Europe’s eastern half will be long and arduous and will last well into the beginning of the next millenium. There will be no magical transformation. If xenophobia and disintegration are to be avoided, generosity, tolerance and integrity will be required. If the transition succeeds without tragedy or violence, the European Bank, together with other institutions, will have provided an impetus for what the whole of Europe could become - a centre of culture and creativity and a continent of freedom and justice, with a sound economic and physical environment, playing its part in the creation of a more tolerant and peaceful world.

Jacques Attali
London, 25 February 1992
Directors’ report

Under the Articles of Agreement Establishing the Bank, all the powers of the Bank are vested in the Board of Governors. As indicated in Article 27, the Board of Governors has delegated most of its powers to the Board of Directors.

The President of the Bank is the Chairman of the Board of Directors. The Board of Directors is responsible for the direction of the general operations of the Bank. It establishes policies and takes decisions concerning loans, guarantees, investment in equity capital, technical assistance, borrowing by the Bank and other operations of the Bank. Under the direction of the Board, the President conducts the current business of the Bank. The President, as chief of staff, is responsible for the organization of the Bank, and makes staff appointments.

At the Inaugural Meeting of the Board of Governors on 16 April 1991, Governors representing the 41 initial members of the Bank elected the first Board of Directors. The Board consists of 23 Directors, who each may appoint an Alternate Director. In most cases Directors who represent more than one member country have appointed an Alternate Director from another country in the constituency.

In accordance with Article 31 of the Agreement Establishing the Bank, the Board of Directors has appointed five Vice-Presidents on the recommendation of the President.

The Board of Directors expresses its sincere appreciation to the staff of the Bank for their substantial efforts in the first operational period of the Bank. Their work has enabled the Bank to commit finance for a significant number of loan and equity operations, and to establish an initial programme of technical assistance activities.

Policies
During 1991, the Board adopted policies concerning the Bank’s operations, its finances and its administration. These have defined the basic approach of the Bank towards fulfilling its mandate in its countries of operations.

The Bank’s first operations publication ‘Operational Challenges and Priorities: Initial Orientations’, approved by the Board at its inaugural meeting in April 1991, examined the main areas the Bank should aim to tackle, and the principal mechanisms at its disposal.

It was agreed that the Bank would place emphasis on activities that support the creation of the infrastructure necessary for private sector development. The Bank will also take a central role in areas such as privatization and restructuring, reform of the financial sector, encouraging foreign direct investment and environmental rehabilitation.

The Board emphasized that the Bank should concentrate its efforts on developing an entrepreneurial spirit at grass roots level by helping small and medium-sized enterprises and by promoting the development of financial infrastructure.

Within this general approach the Board approved operational policies and guidelines which specify the types of project eligible for Bank financing, the main criteria to be used in identifying and preparing a project for Bank financing, the role of the Bank during execution of the project, and the requirement for evaluation of projects when the execution stage is complete.

12 European Bank for Reconstruction and Development
Chairman of the Board of 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 1991 is submitted by the Board of Directors to the Board of Governors. It includes the approved and audited financial statements required to be submitted under Article 27 of the Agreement and Section 13 of the By-Laws. The Annual Report also covers the environmental aspects of the Bank’s operations, as required under Article 35 of the Agreement Establishing the Bank.

President and Chairman of the Board of Directors
Jacques Attali

<table>
<thead>
<tr>
<th>Directors</th>
<th>Alternate Directors</th>
</tr>
</thead>
<tbody>
<tr>
<td>William Curran</td>
<td>Emily Walker</td>
</tr>
<tr>
<td>Claes de Neergaard</td>
<td>Halldór J Kristjánsson</td>
</tr>
<tr>
<td>Tony Faint</td>
<td>Craig Pickering</td>
</tr>
<tr>
<td>Tetsuma Fujikawa</td>
<td>Yoshihisa Kuroda</td>
</tr>
<tr>
<td>James Humphreys</td>
<td>Seung Woo Kwon</td>
</tr>
<tr>
<td>Ron Keller</td>
<td>Paul Menkveld</td>
</tr>
<tr>
<td>Heiner Luschin</td>
<td>Mordechai D Fraenkel</td>
</tr>
<tr>
<td>Giuseppe Maresca</td>
<td>Maurizio Serra</td>
</tr>
<tr>
<td>Alexander Maslov</td>
<td>Serguei Ovsetchik</td>
</tr>
<tr>
<td>Donald McCutcheon</td>
<td>Robert Mackenzie</td>
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<tr>
<td>Patrick Mordacq</td>
<td>-</td>
</tr>
<tr>
<td>Kari Nars</td>
<td>Erik Aarhus</td>
</tr>
<tr>
<td>Guy Noppen</td>
<td>Ernest Muhlen</td>
</tr>
<tr>
<td>Branimir Pajkovic</td>
<td>Stanel Ghencea</td>
</tr>
<tr>
<td>Tomáš Parízek</td>
<td>György Matolesy</td>
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<tr>
<td>Jacques Reverdin</td>
<td>Ibrahim Berberoglu</td>
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<tr>
<td>Christopher Silson</td>
<td>Terry Brown</td>
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<tr>
<td>José da Silva Lopes</td>
<td>Dimitri Koulourianos</td>
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<tr>
<td>Lars Tybjerg</td>
<td>Pol O’Duibhir</td>
</tr>
<tr>
<td>José Luis Ugarte</td>
<td>Vicente Fernández</td>
</tr>
<tr>
<td>Antoine Van Goethem</td>
<td>Peter Blackie</td>
</tr>
<tr>
<td>Jan Winiecki</td>
<td>Plamen Ilchev</td>
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<tr>
<td>Günter Winkelmann</td>
<td>-</td>
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</tbody>
</table>
Bank operations are implemented within the framework of strategies for each country of operations. At its inaugural meeting, the Board established financial policies to enable the Bank to manage the risks inherent in its operations so as to safeguard the highest standing in the opinion of its members, business partners and capital market investors.

These policies establish specific rules about interest rate and foreign exchange risk exposures. They require careful analysis and limitation of credit risk and specify that the Bank's liquid funds must be invested within acceptable credit, market and counterparty risks. These financial policies helped the Bank to obtain a triple A rating from the main rating agencies.

Within this framework, the Board took other important decisions affecting the Bank's finances, including establishing the Bank's accounting policies and determining a schedule for the encashment of capital subscription payments made by members in the form of promissory notes.

The Board approved the Bank's initial borrowing programme of ECU 800 million until the end of 1992, to be carried out in different markets and using different borrowing techniques. As part of the borrowing programme, the Bank's first Bond Issue of ECU 500 million was successfully placed in September 1991.

During 1991, the Board approved detailed portfolio risk management and lending policies, which include:

- limits on the extent of exposure the Bank can take on in any country or sector, or to any borrower,
- terms of loans and equity investments, and
- guidelines for co-financing and the use of financial intermediaries.

The Bank's pricing policy distinguishes between perceived risks both in the public and competitive enterprise sector and terms are adapted to the needs of each project.

The Board considered and approved a policy approach for fulfilling the environmental aspect of the Bank's mandate. This emphasizes the following priorities:

- advisory assistance on environmental policy formulation,
- promotion of business activities in environmental protection and restoration,
- initiation of studies or programmes to address regional and national environmental problems and to promote environmental education,
- adoption of environmentally sound operational procedures throughout all Bank projects and activities.

It was recognized that the environmental aspects needed to be further specified at a later date.

The Board of Directors has approved procedures to implement the political aspects of the Bank's mandate. These provide for the Bank's country strategy papers to assess political progress in each country of operations together with economic progress, using a range of reference points internationally regarded as essential elements of multiparty democracy and pluralism.

Recognizing the critical importance of technical and advisory assistance and training as a preparation for, and complement to, investment operations, the Board encourages the conclusion of agreements with members of the Bank for the provision of resources for these purposes. During 1991, the Bank concluded such agreements with eleven donors, members and non-members of the Bank, amounting to approximately ECU 68 million in total.
The Board would like to express its sincere gratitude to the donors for enabling the Bank to become operational in the key area of technical assistance.

A general policy approach for technical assistance has been approved. Such assistance will be provided to private sector institutions, to central governments and local authorities in individual countries, or in programmes promoting regional integration among the countries of operations as a group. The Bank's technical assistance programme should result in:
- faster build-up of the pipeline of projects,
- more effective investment programmes and projects,
- faster and broader policy reforms, and
- more effective institutional adjustments.

The Board approved the Budget for the period from 15 April to 31 December 1991, within the framework of five-year financial projections and on the basis of an initial work programme from the Bank's various departments. It approved a policy to open resident offices in the countries of operations. The Board expresses its satisfaction that the financial results of the Bank during this period were better than forecast.

At its December 1991 meeting, the Board approved a Budget for 1992 of ECU 91 million for net administration and staff expenses. The capital expenditure programme totals ECU 80 million.

The Board also agreed on the Bank's staff compensation and benefits policy, to ensure a competitive package which attracts high quality staff. The Bank is currently located in temporary premises. The Board approved the recommendation to locate the Bank's permanent Headquarters at One Exchange Square in the City of London.

New members
During 1991, Albania, Estonia, Latvia and Lithuania applied to become members of the Bank. The Board of Directors considered the President's recommendations to accept the applications and approved draft resolutions of the Board of Governors. In October, the Board of Governors voted unanimously in favour of membership for Albania, which completed the procedures to become a member on 18 December 1991. In November, the Board of Governors voted unanimously in favour of membership for Estonia, Latvia and Lithuania.

Strategies for the countries of operations
The Board approves the strategies for operations (lending, equity investments and technical assistance) in each country of operations to ensure that the purpose and functions of the Bank, as set out in Article 1 and 2 of the Agreement, are fully served. Country strategy papers include a review of political and economic developments and identify priority areas for the Bank. They are prepared in consultation with the authorities of the countries of operations.

During 1991, strategies for the following countries of operations were considered and approved: Hungary (June), CSFR (July), Poland (September), Romania (October), Bulgaria (November) and Albania (December). Representatives from the member country's capital, in most cases the Governor of the Bank, have participated in all the country strategy discussions in Board meetings. In view of the political developments in the former USSR and its republics, the Board, rather than adopting a more comprehensive strategy, approved in September a short-term Action Plan for Bank operations with an emphasis on technical assistance. For similar reasons, no strategy has yet been approved for Yugoslavia.
Operations

In the first operational period of the Bank, from 15 April to 31 December 1991, the Board approved 14 projects for investment in the countries of operations. An overview of these projects is presented in the section of this Report entitled 'Highlights': the individual operations are reviewed in the 'Bank involvement' section of each of the country reviews. The total amount committed in loans and equity investments was over ECU 426 million - a catalytic amount which may result in a total investment of more than ECU 1.5 billion with co-financiers and joint venture partners. Some projects are geared towards improving infrastructure in countries of operations, for example in the fields of telecommunications and energy. Others involve loan or equity finance for direct investments in private enterprises. Two projects are specifically aimed at financing small and medium sized private companies.

Cooperation with other international institutions

The Agreement Establishing the Bank requires that the Bank shall work in close cooperation with other international institutions. The Bank works in particularly close cooperation with the European Economic Community and the European Investment Bank, which are both members of the Bank. In June 1991, the Board of Directors approved a policy on the reciprocal exchange of documents with other international institutions, which provides for cooperation in this area with the Commission of the European Communities, the European Investment Bank, the International Monetary Fund, the International Bank for Reconstruction and Development, the International Finance Corporation, the Multilateral Investment Guarantee Agency, the Organization for Economic Cooperation and Development, the United Nations and its Specialized Agencies, the Council of Europe, the International Investment Bank, the Economic Commission for Europe and the General Agreement on Tariffs and Trade.

In November 1991 the Board of Directors recommended that the Board of Governors authorize a general agreement for cooperation with the Council of Europe; this would be the Bank's first such agreement with another international organization.

Working methods of the Board

The working methods of the Board are determined by its extensive involvement in the development of the Bank's operational policies. In addition to regular formal decision-oriented Board meetings, the Board has met regularly to prepare Board decisions. These included workshops with Bank staff to consider proposed policy papers and country strategies, as well as information sessions with Bank staff on many topics related to the Bank's operations.

The Board has established three Committees each containing eight Directors (see Appendices). The Committees report to the Board, through their Chairmen, on issues related to Board decisions:

- the Audit Committee reviews, with the External Auditors, the Financial Statements of the Bank and the Auditors' Report. It considers the Internal Auditor's work programme and the Bank's policy on project evaluation.
- the Committee on Staff Compensation and Administrative Affairs of the Board considers matters relating to administrative policy for the Board. Proposals on staff compensation and benefits are also reviewed by this Committee.
• the Finance Committee examines all aspects of the Bank’s financial policies, including elements of the Borrowing Programme. The Committee is also mandated to consider overall budgetary policy.

The Board has been honoured to be addressed at the Bank by President Mitterrand of France, President Gonce of Hungary as well as a number of Governors of the Bank and other high officials from member countries. Board members have also participated in colloquies and conferences on issues such as the economics of transition, minority rights, and economic law reform, as well as attending lectures by experts on subjects of interest to the Bank and meetings of the Business Advisory Council, the Economic Advisory Council and the Environmental Advisory Council.

Prior to Board consideration of a strategy for a country of operations, a group of Board members usually travels to the relevant country of operations to meet with representatives of government, commercial banks, and industries in the process of restructuring. Board members visited Poland and the CSFR in June, Russia and Ukraine in August, Romania in October and Bulgaria in November. These visits have helped to deepen the Bank’s dialogue with policy-makers in the countries of operations, and provided the Board of Directors with additional insight into these countries.

In addition to representing member countries, Board members act as contact points for the private sector in their constituencies. In this respect Directors and Alternates play an important role in initiating contacts between companies who are interested in doing business with the Bank and Bank staff involved in project preparation. Many Board members have given public presentations about the Bank’s work to corporate groups and banks.
1989

25 October
President Mitterrand of France puts forward the idea for the European Bank in a speech at the European Parliament in Strasbourg, in these words: "What can Europe do? So much more! Why not set up a Bank for Europe...?"

8 December
European Council in Strasbourg endorses proposal to create the European Bank

1990

15 January
Negotiations on establishing the Bank begin in Paris

29 May
Agreement establishing the Bank signed in Paris. This was followed by three post-signature conferences, held in July and October 1990 and January 1991

1991

9 February
First meeting of Economic Advisory Council

15 April
Inauguration of the European Bank for Reconstruction and Development in London. Board of Governors unanimously elects Jacques Attali as the Bank's first President

16 April
First Board of Directors elected

17 April
First meeting of Board of Directors

25 June
First project approved for Bank of Poznań, to finance Polish heating enterprises

13 July
Conference on the Economics of Transition

20 September
First meeting of Business Advisory Council

24 September
First three private sector projects approved

25 September
First bond issue of ECU 500 million

4 October
Board of Governors vote to accept Albania as a member of the Bank

16 November
Colloquy on Economic Law Reform

29 November
Board of Governors approves membership for Estonia, Latvia and Lithuania

18 December
Albania becomes a full member of the Bank

19 December
Meeting with Berne Union (International Union of Credit and Investment Insurers)
Financial Highlights

1991
ECU million

Paid-in capital 2,956
Capital instalments received 591
Medium and long-term borrowing for the period 499
Operating loss 7
New projects approved during the period 427
Total assets 1,129

The Bank has established itself as a prime credit institution in the financial community, achieving a triple A rating from the two largest rating agencies.
### Technical Assistance

**Project Commitments 1991**

<table>
<thead>
<tr>
<th>Region</th>
<th>Description</th>
<th>ECU thousand</th>
</tr>
</thead>
<tbody>
<tr>
<td>Albania</td>
<td>Bank restructuring techniques (training)</td>
<td>11.6</td>
</tr>
<tr>
<td>Bulgaria</td>
<td>Funding proposal for technical assistance in restructuring and privatization</td>
<td></td>
</tr>
<tr>
<td>Baltic Republics</td>
<td>Constitutional Protection of National Minorities (conference)</td>
<td>21.5</td>
</tr>
<tr>
<td>CSFR</td>
<td>Telecommunications - institutional development programme</td>
<td>570.0</td>
</tr>
<tr>
<td>Hungary</td>
<td>Telecommunications - prefeasibility study</td>
<td>27.7</td>
</tr>
<tr>
<td></td>
<td>Budapest urban infrastructure development</td>
<td>610.0</td>
</tr>
<tr>
<td></td>
<td>(assistance in defining a priority investment programme)</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Feasibility study on the establishment of a Giro system</td>
<td>76.4</td>
</tr>
<tr>
<td></td>
<td>Transport - M1 - M15 motorway concession</td>
<td>352.1</td>
</tr>
<tr>
<td>Poland</td>
<td>Feasibility study for Polish mutual fund for privatization</td>
<td>55.8</td>
</tr>
<tr>
<td></td>
<td>Textile industry restructuring, Łódź</td>
<td>2.4</td>
</tr>
<tr>
<td></td>
<td>Social security identification study</td>
<td>48.6</td>
</tr>
<tr>
<td></td>
<td>Gdańsk wastewater treatment</td>
<td>115.0</td>
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<tr>
<td></td>
<td>(project preparation for subsequent investment)</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Deposit insurance system (feasibility analysis)</td>
<td>153.8</td>
</tr>
<tr>
<td></td>
<td>Business Advisory Service</td>
<td>2,200.0</td>
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<tr>
<td></td>
<td>Advisory role in privatization</td>
<td></td>
</tr>
<tr>
<td>Romania</td>
<td>Telecommunications - institutional development planning</td>
<td>533.0</td>
</tr>
<tr>
<td></td>
<td>Telecommunications - project management review</td>
<td>62.3</td>
</tr>
<tr>
<td></td>
<td>Assistance in implementation of 'early privatization' programme</td>
<td></td>
</tr>
<tr>
<td>USSR</td>
<td>Moscow City Council privatization programme</td>
<td>1,230.0</td>
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<td></td>
<td>International School for Banking and Finance, Moscow</td>
<td>2,300.0</td>
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<tr>
<td></td>
<td>International School for Business, Management and Privatization</td>
<td>1,000.0</td>
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<tr>
<td></td>
<td>Privatization, St Petersburg</td>
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<td></td>
<td>Initial advisory programme, St Petersburg privatization</td>
<td>914.0</td>
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<td></td>
<td>Far East port and food distribution feasibility study</td>
<td>12.3</td>
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<td></td>
<td>Advice on securities market</td>
<td>7.4</td>
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<tr>
<td></td>
<td>Transport and logistics study (food distribution)</td>
<td>378.3</td>
</tr>
<tr>
<td></td>
<td>Agriculture pricing policy and food distribution survey</td>
<td>81.0</td>
</tr>
</tbody>
</table>
Review of the region of operations

In achieving transition to a working democracy and market economy, half of Europe - the central and eastern European countries - faces a formidable array of complex problems which need to be tackled urgently, but which will take many years to overcome fully. This poses a major challenge: to create a new economic framework, while simultaneously changing the political system, behaviour, and even the attitudes of the people involved, without creating intolerable social conditions which could seriously endanger their societies and threaten those nearby. There is no historical precedent for such restructuring.

The establishment of appropriate legal and financial institutions will be crucial to successful transition. Privatization has a key role to play, as well as the mobilization of domestic and international savings and investment. At the same time, reform of infrastructure is essential to build the foundations of a market economy, and represents the areas of greatest potential for regional integration and for the interlinking of the eastern and western halves of the European continent. Finally, the extent of the region's environmental problems gives rise to great concern and requires urgent action.

The following regional reviews address several sets of interrelated issues, giving a general overview of the situation and discussing the Bank's priorities and involvement: political and legal; economic and trade; financial, privatization and foreign direct investment; key areas of infrastructure - transport, telecommunications, energy and municipal development; and the environment.

Political

In recent years central and eastern Europe, including the former Soviet Union, has undergone immense political and economic change. Countries of the region decided, with astonishing rapidity, to move away from communist regimes and centralized command economies and to embrace democracy and the market.

The end of the Cold War, which had assured a certain international stability, altered the geopolitical balance of the world. It opened the door to the advance of democracy and arms control. It also heralded new types of international tension and conflict, springing not only from military concerns but from new threats of large-scale migration, environmental degradation and unemployment. The political and economic dimensions of these changes were closely interlinked.

What made such momentous events possible? It became clear by the mid-1980s that economic systems were under strain throughout the central and eastern European countries, despite sporadic reform efforts. Although the need for drastic change in the system itself was obvious, it was not until the introduction of President

Countries of operations

Albania
Bulgaria
CSFR
Estonia*
Hungary
Latvia*
Lithuania*
Poland
Romania
USSR
Yugoslavia

*Membership approved by the Board of Governors, but not effective as of 31 December 1991

24 European Bank for Reconstruction and Development
Gorbachev’s glasnost and perestroika policies that the reform process throughout the region gained momentum. The fact that intervention in the internal affairs of other central and eastern European countries was no longer a significant aspect of Soviet foreign policy represented a great turning point in the history of the region.

Most of the European Bank’s countries of operations made tremendous democratic progress and firm steps toward open market economies in 1991, albeit at a somewhat slower pace in the economic sphere than they and others might have expected in the early euphoria of freedom. This was especially the case in Albania, where economic difficulties are the most acute of the region.

Despite severe economic problems, most of their governments generally enjoyed broad, if sometimes apathetic, support. Careful governance, coupled with a strong commitment to democratic values allowed most of them to maintain a delicate political balance, not least in the CSFR, where democratic debate continued about the extent of powers of the Federation and the Czech and Slovak republics.

New systems of local government, featuring institutional and operational autonomy and immediate accountability to constituents, were established in most central and eastern European countries. Imprecise legislation and inadequate funding might have hindered development, but a firm beginning was made. Trade unions were generally free to act independently, although in some countries the trade union movement was still weak. Freedom of the press made remarkable strides and the media proved a powerful influence in most countries, despite usually being constrained by economic difficulties.

New constitutional provisions were a priority for all countries in the region. Using the accumulated experience of democratic societies and international standards for human rights, legislators based the drafting process on wide-ranging popular participation. The process is not yet complete. Bulgaria was the first country to adopt a new constitution, followed by Romania. Other countries are still deliberating specific provisions. Meanwhile, guarantees covering a broad range of civil and political rights, including freedom of religion, speech, the media, equality under law and local self-government, were enacted. The practical effort of these rights varied from country to country depending on the strength of the political and judicial institutions concerned.

Following Hungary, the CSFR and Poland joined the Council of Europe in 1991 and signed the European Convention on Human Rights and Fundamental Freedoms. Most of the Bank’s other countries of operations have indicated their intention to do likewise. All were active in the CSCE, of which the CSFR holds the Chairmanship as 1992 begins.

However the political situation throughout the region, but most particularly in the former Soviet Union and Yugoslavia, was fragile. The chosen path of democracy and market economics brought with it the difficult task of setting up completely new political and economic mechanisms and dealing with their social consequences. The pace of reform was the critical question: an excess of radicalism or gradualism could put the whole process at risk. It was recognized that overall stability and success in attracting foreign investment depended on the readiness of major political movements to cooperate in the transition. There was also the difficult task of balancing radical action and social costs. There was no established formula to apply to such unprecedented change. Although freedom was often achieved in a matter of hours, the creation of the indispensable instrument for the preservation of freedom, a democratic society, was seen to take longer.

By the end of 1991, the USSR had formally ceased to exist. Several of its former republics had already gained widespread international recognition of independence. Unlike the other countries of central and eastern Europe, the new states emerging from the dissolution of the Soviet Union faced the challenge of post-communist development with a completely untried set of political institutions and what many of their people believed to be the negative experience of six years of perestroika. Reforms implemented during that period were more liberalization measures than clear steps toward the fundamental dismantling of the totalitarian structure. The slow, erratic reform process led to social discontent.

The civil conflict in Yugoslavia was a painful realization of the threat of instability. The independence declarations of the Yugoslav republics of Croatia and Slovenia in June 1991, resisted by Serbia and the Yugoslav
Federal Army, set off escalating violence that defied the mediation efforts of the European Community and the United Nations in 1991. The issues of national sovereignty and ethnic and minority rights concerned in the conflict highlighted potential problems elsewhere in the region, raising the fear that they would escalate.

Throughout the region, many governments also had to face ethnic minority concerns, including citizenship rights and minority language education questions. Ethnic issues showed potential to disrupt relations between, as well as within, states, especially where governments claimed to represent people of their own ethnic origin living in neighbouring countries. Territorial claims based on ethnic claims or dating from the end of the Second World War are also a potential source of conflict.

The main risk ahead is for democracy. Failure to achieve economic growth quickly may feed political fragility. The role of the freely elected parliaments, both in monitoring administration and government and in generally supervising the remaining, large, state-owned sector, will thus be crucial, as will appropriate mechanisms to mediate among the competing interests of governments, the private sector, workers, and other social groups. Democratic accountability of governments may impose certain constraints on economic reform, especially where a widespread fall in living standards is involved. Different countries are likely to choose different paths, according to their individual preferences and traditions.

The countries of central and eastern Europe have shown themselves determined to create new democratic market economies. The linkage between the political, economic and social components of the changes have become increasingly clear. A market economy requires an adequate legal and democratic political framework to foster the spirit of enterprise, individual rights and institutional stability necessary for sound investment.

**Bank involvement**

It was against this background that the Agreement establishing the European Bank was agreed in 1990 and the Bank became operational in 1991, with unique political and economic aspects to its mandate to help the transformation to multiparty, pluralistic market economies. This idea was enshrined in the Agreement, which extends the political aspects of the Bank's mandate to all elements of the Bank's operations. The Bank therefore monitors progress toward multiparty democracy in each of its countries of operations to contribute to the formulation of the Bank's strategy for the country. The Bank seeks to encourage civil and political rights essential to the full development of multiparty democracy and pluralism as part of that strategy, so as to work with the country to help it ensure its continued adherence to the Bank's purpose.

Examples of such rights are free elections; representative government in which the executive is accountable to the elected legislature or the electorate; freedom of speech and assembly; freedom of conscience and religion; freedom of movement; the right to private property; availability of redress against administrative decisions; separation between the State and political parties; independence of the judiciary; equal protection of the law, including for minorities; fair criminal procedure; and the right to form trade unions and to strike. As stipulated in the Bank's founding Agreement, if the Bank's assessment of a country of operations' democratic progress indicates that it is implementing policies inconsistent with the Bank's purpose, the Bank's Board of Directors may consider proposing that the Board of Governors suspend or otherwise modify some or all of Bank operations in that country.

The Bank's explicit link between lending and investment operations and civil and political rights codifies the ideal that the long-term success of efforts to transform the former communist states into successful market economies turns to a significant degree on their willingness and ability, both real and as perceived by potential investors, to safeguard civil and political rights in accordance with international standards. This link between economics and democracy is the new framework for the future.
Main events in central and eastern Europe in 1991

4 January
Jan Krzysztof Bielecki elected Polish Prime Minister by Sejm at head of Solidarity Government

20 February
CSCE Secretariat established in Prague

21 February
CSFR joins Council of Europe. Hungary is already a member

31 March
First free Albanian election results in victory for ex-Communists, although they suffer major losses in urban areas to opposition Democratic Party

20 May
Stipe Mesic, a non-Communist Croat, assumes Presidency of Yugoslavia, despite opposition from Serbia and her allies

1 June
Warsaw Pact dissolved

4 June
New coalition "government of national stability" in Albania, under Ylli Bush, installed after resignation of Fatos Nano's government following a four-week general strike

12 June
Boris Yeltsin democratically elected President of the Russian Republic, winning 58% of the popular vote

19 June
Albania admitted to CSCE

25 June
Slovenia and Croatia declare independence from Yugoslavia

28 June
Comecon dissolved

12 July
Bulgarian Parliament adopts new constitution

15 July
G-7 summit begins in London, attended by Mikhail Gorbachev

19 August
Conservative hard-liners, led by senior ministers, assume power in Soviet military coup, on the eve of proposed signing of Union Treaty. Mikhail Gorbachev is kept under house arrest in Crimea

21 August
Coup collapses after losing army support and encountering popular resistance, led by Boris Yeltsin. Leaders are arrested and President Gorbachev returns to Moscow

6 September
Moscow recognizes the independence of Estonia, Latvia and Lithuania

7 September
Yugoslavian leaders attend peace conference in The Hague, held under auspices of EC, and chaired by Lord Carrington, former British Foreign Secretary and Secretary General of NATO

10 September
CSCE Conference on the Human Dimension opens in Moscow. Estonia, Latvia and Lithuania admitted to CSCE

26 September
Petre Roman resigns as Romanian Prime Minister after miners riot in Bucharest. Replaced by former Finance Minister Teodor Stolojan, an independent

13 October
UDF wins Bulgarian election, but fails to secure absolute majority. UDF leader Filip Dimitrov eventually forms government with the backing of the Movement for Rights and Freedom, an ethnic Turkish party

27 October
Polish election produces fragmented Sejm. The two leading parties are the Democratic Union, led by former Prime Minister Tadeusz Mazowiecki, and the ex-communist Democratic Left. Efforts to constitute a governing coalition begin

21 November
Romanian Parliament adopts new constitution

26 November
Poland joins Council of Europe

8 December
Russia, Belarus and Ukraine sign Commonwealth of Independent States Treaty

10 December
Vilson Ahmeti appointed Albanian Prime Minister, at head of interim government of mainly non-party technocrats, after Democratic Party leaves government

16 December
EC Council of Ministers agree to recognize those Yugoslav republics wishing to proceed with independence on 15 January 1992, provided human rights and the rights of minorities are respected, and the republics have no claims on the territory of other sovereign states and republics

20 December
Ante Markovic, resigned from his post of Federal Prime Minister of Yugoslavia, in protest at 81% of the draft 1992 Federal Budget being proposed for army expenditure.

21 December
Eleven Soviet Republics sign Commonwealth Treaty at Alma-Ata. Only Georgia does not sign

31 December
USSR formally ceases to exist
In achieving transition to a working democracy and market economy, the central and eastern European countries face a formidable array of complex problems: political and legal; economic and trade; financial, privatization and foreign direct investment; as well as in key areas of infrastructure - transport, telecommunications, energy and municipal development; and the environment.
Review of the region of operations
Review of the region of operations
Legal

The successful transition from command to market economies requires the establishment and development of vastly different legal structures which will support free market enterprise within each of the economies in transition. Moreover, adequately safeguarded constitutional rights, soundly administered privatization and foreign investment laws, the protection of private property rights and effectively enforced bankruptcy, securities and bankruptcy regulations will assist the former communist countries in their integration into the international economy. This is widely recognized. Nevertheless, the response to the urgent need for law reform has been inadequate in a number of respects. Efforts to build legal systems capable of supporting market economies have often resulted in conflicting codes, legislation which can be neither implemented nor enforced, and general uncertainty which impedes efforts to attract investment in the region. A particularly difficult problem has been presented by the issue of restitution of property rights, which has further complicated the difficult process of privatization.

During the last few years each of the Bank's countries of operations has enacted a wide array of constitutional and economic laws. Nonetheless, the drafting of new legislation is bound to continue at an active pace for some time. New laws enacted in haste, as many have been, will need revision. In addition, where countries have chosen to rely on codes enacted prior to 1946, extensive amendments may be required. Amendments will also be required where interim measures were enacted with the intention that they be elaborated upon in the future.

One question the recent drafting of new legislation has raised is that of sequencing. Which laws ought to be enacted immediately, and which must wait until the legal system is further developed? A related question is whether it is either realistic or desirable for central and eastern European countries to coordinate or harmonize their laws with those of the western industrialized states in order to facilitate access to global markets.

The drafting and revision of codes and regulations also raises important concerns regarding the ability of governments to implement and enforce these new laws. Some countries have placed undue restraints on the executive which hamper its ability to implement new laws. Of even greater concern is the fact that many of the Bank's countries of operations have no means of systematically examining the effectiveness of their new laws.

The inexperience of the judiciary in commercial law matters is also a problem. Judges are not alone in their need for training. Corporate counsel, private practitioners, public administrators, magistrates, and law professors could all benefit extensively from educational programmes.

Bank Involvement

As a first step toward fostering legal reform in central and eastern Europe, the Bank organized a colloquy entitled 'Setting an Agenda for Technical Assistance and Training for Reform of Economic Law in Central and Eastern Europe', in association with the International Development Law Institute and the Harvard Programme on International Financial Systems. Held at the Bank's headquarters on 15-17 November 1991, the colloquy was attended by 21 participants from eight central and eastern European countries, and legal scholars and representatives from multilateral, bilateral and private financing organizations including the EC, EIB, BIS, NIB, Council of Europe, IMF, OECD, the World Bank Group (IBRD, IFC, MIGA) as well as US AID, the UK Know-How Fund and many other country organizations.

The colloquy focused on legal obstacles to foreign investment and entrepreneurial initiatives in the Bank's countries of operations, the merits and shortcomings of the legal technical assistance projects under way and areas where legal technical assistance was most needed and would be most effective.

At the conclusion of the colloquy, the Bank was invited to play a key role in the effort to institutionalize the exchange of information among all parties. To enable the Bank to act as a source of information relating to legal technical assistance and training in its countries of operations, the Office of the General Counsel has embarked upon:
- the development of a database of technical assistance and training programmes,
- the formation of an international advisory committee, comprised of representatives from the various international financial institutions, professional organizations and
academic institutions, which will seek to increase coordination and information sharing among the providers of assistance, and

- the establishment of counterpart advisory committees within the central and eastern European countries to address needs and priorities in their respective countries and to work with the international advisory committee to create a targeted response to specific needs.

### Economic

This review addresses the economic developments of the central and eastern European region as a whole in 1991. The significant differences existing among the individual countries and general trends are outlined below, while trade, both within the region and beyond, is discussed in more detail in the following section.

Hungary began its reform in 1968, Poland enacted various liberalization measures during the 1980s. Yugoslavia had pursued an economically distinctive path for many years. In the CSFR the traditional command economy remained virtually unchanged until late 1989. In Albania, Bulgaria and Romania, economic reform began relatively recently, whilst the former USSR was separating into economically autonomous states, several of which were to introduce radical reforms at the beginning of 1992.

This diversity is a hazard to generalization, but not the only one: the quality, consistency and coherence of statistical data are far from ideal. Official, black market and purchasing power parity exchange rates can give widely varying estimates of GDP per head (see above and right). Administered exchange rates, unlike market rates, need not be consistent as to their cross rates and inconsistent rates make the delineation of the pattern of trade especially difficult. The emergence of private enterprises outside the planning structure before comprehensive fiscal and statistical measures are in place, means that the picture of private activity is far from complete. Registration of an enterprise is no guarantee that it is operational and is totally uninformative as to its scale; this applies equally to joint ventures with foreign participants. Moreover, under national accounting conventions, officials laid off and going onto social assistance represent a loss of output even if their activities were not economically useful. Similarly, when relative prices have changed radically, activities which added value at the old prices might cease to do so at the new ones - the 'closure' reduces GDP at old prices but raises it at the new ones. Thus, closing enterprises characterized by negative value added does not reduce GDP, although the output of a particular product may fall.

### Measurement problems

The statistical problems referred to in the text are particularly acute in relation to GDP per head. The table above (from the Austrian Institute of Economic Research, November 1991) sets out 10 estimates for up to seven countries.

The range of estimates varies from a ratio of 2.5 for Yugoslavia to over five for the USSR, the other five countries have ratios between three and four.

Apart from problems raised by the incomplete coverage of socialist NNP relative to conventional GDP, and problems of rationing, the key question relates to the exchange rate used to convert national currency estimates into hard currency estimates. Most of the estimates presented use the purchasing power parity approach which involves comparing the local and international prices of a large number of items.

The physical indicator approach relies on data on availability of specific types of goods.

For the tables attached to the country reviews below, we have rounded the 1990 PlanEcon figures which are relatively recent, have relatively good country coverage and are relatively central.
Throughout the region, 1991 might reasonably be summarized as a year of economic disappointment, or at least of hopes deferred. Only in the case of exports to the West, and that not everywhere, did performance exceed expectations, even though Agreements between the CSFR, Hungary and Poland with the European Community, signed in December 1991, failed to fulfill all the hopes of the countries concerned.

In nearly all cases, heavily laden legislative programmes slipped, as they tend to do everywhere. Problems of restitution, with important implications for the privatization timetable, proved particularly troublesome. In several cases, such as laws on bankruptcy, approval of legislation did not necessarily lead to widespread implementation. When technical insolvency of many state-owned enterprises is very common, the decision to launch a particular procedure may have serious social implications and therefore is taken with understandable reluctance.

Despite the unpropitious circumstances, some progress was made in 1991 with privatization, notably small privatizations. Large scale privatization and associated restructuring have been delayed by the fact that fewer enterprises than had been expected are profitable.

**Stabilization, output and employment**

Stabilization programmes invariably impose fiscal and monetary restrictions which reduce demand and output. As chart 1 shows, output, measured subject to the problems mentioned above, fell 10-20 per cent from its previous peaks and, in most cases, is likely to fall almost 25 per cent before it starts to recover.

Nearly all the countries embarked on reform with high levels of repressed inflation attributable to the monetization of large fiscal deficits which were eliminated in several cases in 1990 as subsidies were substantially reduced. Sustaining this improvement in 1991 proved difficult where recession caused rising unemployment and falling profits of state-owned enterprises which accrued to the government. The implementation of tax reforms appropriate to a market economy will take time everywhere. Credit restrictions and high interest rates in those countries also controlling their fiscal positions helped to contain monetary growth, but at the expense of new small and medium sized enterprises that did not have established links with financial institutions still in state hands.

Privatization proceeds made only a modest contribution to the absorption of the monetary overhang or of continuing monetary emission.

Although restructuring, linked to privatization, has hardly yet got under way, unemployment started to rise towards levels typical of western Europe - and shows no sign of stopping there (see chart 2). Of course, the very low levels reported before the reform process began were not associated with a well-functioning labour market, but reflected administrative arrangements. The legacy of labour immobility, as well as a poorly functioning housing market, continued to limit flexibility in the labour market.

Labour force participation rates in centrally planned economies were much higher than in the West. Although one might expect some movement towards the patterns of the West, the transition is likely to be protracted as families are dependent on multiple incomes. Even though measured real wage falls exaggerated the decline in living standards, as previous cash incomes could often not be spent on goods available at official prices (the ration of available goods did not absorb all the available cash income, the surplus accumulating as part of the monetary overhang), a rapid fall in participation could prove difficult to absorb.

The figures for employment and output respectively imply a fall in productivity. That, of course, is quite normal during a recession. Furthermore, shedding labour remains a last resort of many managers, particularly when ownership issues are unresolved, workers' councils influential in state-owned enterprises and profit incentives weak.

**International aspects**

An important factor contributing to the fall in output throughout the region in 1991 was the collapse in trade between the former Soviet Union and its former CMEA trading partners. This fall of about 25 per cent was attributable to the shift in the basis of trade to hard currency and world prices and to falling oil production. Moreover, an inherent bias prevailed against spending scarce hard currency on goods formerly available on soft terms. The deterioration in their terms of trade reduced the real incomes of some countries by about 10 per cent.
The gross financing of the region probably reached about US$ 30 billion. Nearly half of this was attributable to the USSR despite its having a trade surplus, and was met by gold and currency reserve sales, debt relief and bilateral assistance. Most of the financing of the other countries was covered by official financing, much of it through IFIs. Only about US$ 3 billion took the form of private foreign direct investment.

The accumulation of unsold stocks of export goods, often financed at very high real interest rates by the producing enterprises, masked, in some cases, the very substantial reduction in inventories consequent to a move to free markets. Just as households have less reason to hoard when goods can be relied upon to be available in shops, so too do enterprises have less reason to carry high levels of inventory. In the former Soviet republics, partial reform and continuing inflationary expectations meant that this destocking and consequent falls in demand did not occur.

The collapse of trade deprived the former Soviet Union of essential imports and spare parts, thus contributing to a fall in output similar in magnitude to that of the central European states which had undertaken more radical and systematic reform. They, in turn, suffered from the loss of markets for goods not, in many cases, readily saleable elsewhere. Furthermore, hard currency expenditure by the former Soviet Union was pre-empted by the need to service its debt.

In the coming years, substantial external finance will be required for economic growth in the region, although the bulk of capital formation will be financed by domestic savings which then contribute more to GNP. Investment has been relatively resilient in the face of recession which also depresses savings. A major task of the domestic financial sector is to mobilize and allocate savings efficiently. All the countries of the region face difficulties in borrowing from world capital markets where real interest rates are high and tightened banking standards call for provisions against many borrowers, even Hungary which, despite the size of its debt, has always met its obligations.

Prospects for prices and output

Inflation accelerated in the Soviet Union as its republics increasingly asserted their autonomy and the consolidated fiscal deficit rose towards 20 per cent of GDP. Stabilization of prices has been relatively successful in central and eastern Europe (see chart 3) though only in the Czech and Slovak Federal Republic, with an official forecast for 1992 of inflation between 10-15 per cent, does the achievement of price stability seem to be within reach.

An important development, with implications for the evolution of prices, has been the adoption by several countries of predetermined crawling adjustments to exchange rates fixed, increasingly, in terms of published composite currency baskets. This is a significant step to increase the credibility of an important anchor to the domestic price level. The alternative of discrete exchange rate adjustments at uncertain intervals creates a tension between the high nominal interest rates on domestic currency appropriate to stabilization and the much lower rates on the reference currency undermining the credibility of assurances that the exchange rate is not going to change. A consistent partial accommodation of differential cost movements, designed to constrain domestic inflation at the expense of an initially cumulating loss of competitiveness, is liable to make the ultimate restoration of competitiveness depend on domestic inflation eventually falling below that of the reference currency - which is unlikely to be seen as very credible.

The movement towards separate currencies for the former Soviet republics is likely to gather pace as does inflation. In the process, the value of the rouble, the rate for which had reached nearly 150 roubles to the US dollar by the end of 1991, is liable to be weakened further. However, the market value of a currency using administered rates for most international dealings is not a reliable guide to the value it would have if it were made freely convertible. In the
presence of a monetary overhang, the free market price of an otherwise inconvertible currency understates its value, if convertible, to a similar extent that the official price overstates it; in an otherwise rigid economy, the free market exchange rate, as the only simultaneously flexible price, is extremely sensitive to disequilibria anywhere in the system.

It seems likely that the countries of the region will reach turning points in their economic activity in a similar sequence to that of their progress in reform; those that were first to initiate reforms being the first to resume positive growth. In Albania, acute political uncertainties must be resolved as a precondition for economic growth while, in Yugoslavia, a settlement of the civil war and of economic relations between the states is a necessary precursor of reconstruction and widespread recovery. Likewise, were there to be a disruption of trade between the successor republics of the USSR, output there, which has already fallen nearly 20 per cent from its peak, would fall considerably further, as the interdependence of the states is exceptionally high.

Trade

External trade of central and eastern European countries, including the former Soviet Union, fell sharply in 1990 and 1991. Measured in volume, total exports of the region declined by about 10 per cent in 1990 and by about 25 per cent in 1991 (Table 1).

Imports fell by five per cent in 1990 and were estimated to have contracted by more than 20 per cent in 1991. In particular, the trade balance of non-Soviet ex-CMEA members shifted from an overall trade surplus in 1990 to an overall trade deficit in 1991. The dramatic contraction in trade in central and eastern European countries is widely attributed to domestic recessions and to the collapse of the Comecon system.

The domestic recessions were partly brought about by the macro-stabilization policies implemented in most of the countries, which led to a substantial reduction in aggregate demand for imported goods.

Trade collapse in the region also contributed to domestic recessions, in particular through the following three channels of transmission:

- a supply shock component, namely the realignment of (Soviet) energy and raw material prices to world market levels, which induced a severe deterioration (15 to 20 per cent) of the terms of trade of central and eastern European countries, vis-à-vis the former Soviet Union;
- a demand shock component, namely the loss of Soviet markets by the other central and eastern European countries. This loss is mainly attributed to the switch from transferable roubles to hard currency trade within the ex-CMEA zone, combined with a dramatic shortage of hard currency in the various countries, especially the former Soviet Union, where hard currency was badly needed to service its external debt;
- the limited degree of technological substitution to accommodate the loss of essential imported inputs.

The extent to which the collapse of CMEA accounts for the observed contractions in GDP throughout the region depends on each country’s involvement in former CMEA trade. The deep recession in Bulgaria, in particular, was more attributable to the loss of Soviet markets than that experienced by Hungary or Romania, (Table 2).

Trade among central and eastern European countries shrunk by 20 per cent in 1990 and by 20-25 per cent during the first half of 1991. Trade between these countries and the European Community, however, has increased by 13 per cent since 1989. Table 3 and related charts detail the westward reorientation of central and eastern European trade since 1989.

Exports from central and eastern Europe are concentrated in four main areas: agriculture, iron and steel, textiles and chemicals. All these are considered sensitive by OECD countries (including the European Community) and are subject to special rules, tariffs and non-tariff barriers. These last have been estimated to be equivalent to additional tariffs of about 100 per cent on agricultural goods and food, 25 per cent on textiles and apparel, and 10-20 per cent on chemicals imported into OECD markets.

The trade collapse in the region is essentially that between the former Soviet Union and its ex-CMEA partners: Soviet imports from central and eastern Europe (in value) fell by 15 per cent in 1990 and by 45 per cent in 1991. (Soviet exports to central and eastern Europe fell in
"CEE - from central and eastern Europe
USSR - to Soviet Union
DE - to developed economies

"CEE - to central and eastern Europe
USSR - to Soviet Union
DE - to developed economies

volume but not in value, due to the realignment of Soviet energy prices to world levels. The contraction of trade flows between the CSFR-Hungary-Poland remained limited (10 percent in 1990 and less than 20 percent in 1991) and the reduction in trade between Bulgaria and Romania since 1989 was negligible. Trade between the CSFR-Hungary-Poland and Bulgaria-Romania, however, contracted by more than 60 percent since 1989.

The current framework for trade between central and eastern European countries involves a set of bilateral treaties. These treaties provide for some kind of administered trade by means of pre-specified ‘indicative lists’. In practice, however, trade between enterprises in central and eastern European countries has been mediated through direct (bilateral) barter deals intended to bypass the hard currency constraints on enterprises imposed by governments (in particular the previous Soviet administration). The present institutional structure for trade suffers from a “lack of export credit facilities and export insurance schemes, inefficiency of customs services, lack of financial and technical infrastructure (and) the lack of enterprise level marketing and managerial skills needed to operate in a competitive market environment” (ECE Bulletin, November 1991).

To remedy the collapse of trade between central and eastern European countries, their governments attempted to create openings such as bilateral clearing arrangements, agreements on using national currencies in trade through special bank accounts (e.g., between CSFR and the former Soviet Union) and official barter deals (e.g., between Bulgaria and the former Soviet Union since June 1991). Such bilateral barter arrangements are far from ideal. They have not succeeded in preventing the collapse of trade between eastern Europe and former Soviet republics and they are unlikely to prevent a more dramatic collapse of trade between the former Soviet republics themselves. Such a collapse would be all the more disruptive for the production activities of the former republics as they had become highly specialized, under the previous system, in the production of complementary goods. The high degree of trade dependence of the republics is illustrated in Table 4.

There may be scope for making multilateral, the bilateral clearing arrangements that are likely to emerge. While such arrangements have been criticized as preserving an obsolete pattern of trade, the alternative, in the short run, could be a severe diminution of trade on an extremely inefficient barter basis. The ultimate objective must be the full convertibility of all the currencies of the region and the complete integration of their economies into the world trade system.

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**Table 4**

<table>
<thead>
<tr>
<th>Country</th>
<th>% of NMP</th>
</tr>
</thead>
<tbody>
<tr>
<td>Russian Federation</td>
<td>48.0</td>
</tr>
<tr>
<td>Ukraine</td>
<td>39.1</td>
</tr>
<tr>
<td>Belarus</td>
<td>69.6</td>
</tr>
<tr>
<td>Estonia</td>
<td>66.5</td>
</tr>
<tr>
<td>Latvia</td>
<td>64.1</td>
</tr>
<tr>
<td>Lithuania</td>
<td>60.9</td>
</tr>
<tr>
<td>Moldova</td>
<td>62.1</td>
</tr>
<tr>
<td>Georgia</td>
<td>53.7</td>
</tr>
<tr>
<td>Armenia</td>
<td>63.7</td>
</tr>
<tr>
<td>Azerbaijan</td>
<td>58.7</td>
</tr>
<tr>
<td>Kazakhstan</td>
<td>30.9</td>
</tr>
<tr>
<td>Turkmenistan</td>
<td>50.7</td>
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<tr>
<td>Uzbekistan</td>
<td>43.2</td>
</tr>
<tr>
<td>Tajikistan</td>
<td>41.6</td>
</tr>
<tr>
<td>Kyrgyzstan</td>
<td>50.2</td>
</tr>
</tbody>
</table>

Source: Oszmynek Pekatlitzki (1990), page 4, 43-49, 49, 44; Norkhol 1990 (1990), page 634
Financial sector

Current situation and recent developments

The development of an efficient market-based financial sector is one of the Bank's highest priorities. The desired transformation from a centrally managed economic system to a market economy based on autonomous investment and credit decisions depends on the establishment of banks and other financial institutions with the incentives and skills required to play an effective role in mobilizing financial resources and allocating those resources to competing investment demands.

Commercial banks established in the Bank's countries of operations typically fall within two main categories: (i) commercial banks which were created out of the former 'monobank' system, remain state-owned, have strong operational ties with large public enterprises and carry significant proportions of non-performing loans in their portfolio; (ii) newly established domestic and joint-venture banks which concentrate on the provision of basic banking services and relatively secure, short-term lending to a client base dominated by large, often foreign or joint-venture, corporate clients.

With regard to state-owned banks, two patterns have emerged depending on the manner in which the former 'monobanks' system was dissolved. One model broadly applies to countries in which commercial operations of the former National Bank were transferred into a single new state-owned commercial bank with a nationwide network of branches. Another model is characterized by the division of the commercial activities of the former National Bank into smaller regional banks each with an effective monopoly in their respective geographical area. This model applies to the CSFR, Poland and Bulgaria where the former National Bank was split into two, nine and over fifty regional banks, respectively. In either case, competition has been slow to emerge either in collecting deposits, making loans, or providing basic banking services. In Hungary, because the process of transformation began as early as 1987, there is greater competition and diversity among the state-owned banks as well as competitive pressure from new private banks.

Former 'specialized' banks which served clients in specific sectors, such as agriculture, industry or foreign trade, have also been transformed into joint-stock companies and are attempting to evolve into full-service commercial banks. However, they often lack the branch networks to compete effectively. All commercial banks have little experience collecting deposits as this activity continues to be dominated by the National Savings Bank. In some countries such as Romania, Hungary, the CSFR and Poland, the National Savings Bank is expanding its loan portfolio to compete with the other banks as a full-service bank.

Cooperative banks, which exist in most of the Bank's countries of operations, have the potential to serve individual, well-defined groups of savers and investors to meet local requirements, provided their banking skills are rapidly improved.

There is considerable pressure and incentive for all these banks to continue lending to enterprises in default because of historical and institutional connections, concerns regarding further falls in output and employment, and pressure not to recognize non-performing assets on the portfolio. Moreover, many state enterprises and state-owned banks have patterns of co-ownership which would lead to conflict of interest problems in a truly competitive environment.

New domestic private and joint-venture banks have demonstrated an early capacity to be profitable through the provision of basic banking services. Some have also had success in attracting deposits. Since most new banks choose a cautious business strategy which focuses on basic trade and working capital finance (i.e. short-term), they are beginning to draw high quality business away from the state-owned banks. Policy decisions regarding the future of state banks, therefore, become all the more urgent, as the 'flight to quality' creates further portfolio problems. Moreover, higher pay scales in the private sector can cause the 'flight of managers' away from the larger, state-owned institutions to smaller private banks.

Private banks, where they exist, represent less than 10 per cent of total assets in the most advanced financial sectors (e.g. Hungary). However, the greater profitability of these banks implies that the private sector will gradually increase its market share through the expansion of existing private Banks' business and the entry of new banks into the market.
Countries vary substantially in the degree to which market mechanisms are beginning to be observed in the allocation of credit. Interest rates in the more developed countries are positive in real terms despite high rates of inflation, while other countries continue to have administered interest rate structures which have not adjusted fully to the inflationary environment. In most countries, deposit mobilization is dominated by the Savings Bank which channels these resources through various inter-bank lending mechanisms. These have a retarding effect on the establishment of market-based rates of interest normally generated through the competition for resources among financial institutions. Credit ceilings are relied upon in most countries for the control of monetary aggregates although all countries have taken steps or intend to move towards open-market operations.

**Issues in the reform of the sector**

Despite the transformation of the 'monobank' in each of the Bank's countries of operations into several publicly owned joint-stock companies, there can as yet be little confidence in the capabilities of these banks to make sound credit decisions or provide the services necessary for a market economy. Their former role was to execute financial allocations according to the central plan with the result that skills associated with banking are underdeveloped. Therefore, the appointment of competent managers, extensive programmes of training for bank staff, as well as a restructuring of bank balance sheets burdened by bad debts, are of the utmost importance both for the countries of operations and for the Bank.

The non-performing loans of large public sector banks require an urgent solution which must be integrated with general restructuring of the economy. Many banks have portfolios which, if classified on the basis of strict accounting criteria, would mean they were technically insolvent. Many loans which are currently classified as performing are likely to go into default when borrowers are restructured, privatized, closed-down or begin to face a more competitive environment. Given the incentives to continue rolling over short-term credits to enterprises technically in default, it is possible that in many countries the portfolios of banks are getting progressively worse. A solution to the loan portfolio problems is an urgent priority in order to allow new loans, particularly to private sector borrowers, to reduce lending spreads and not be forces of funds and to facilitate the privatization of the banks on a case-by-case basis.

An issue of mounting importance, especially as the number of smaller private banks increases, is the establishment of an effective legal and regulatory environment. While countries vary in the pace and sequence of enactment of key legislation (such as banking laws, securities laws, accounting laws and land and private ownership laws etc.), new laws and regulations have been adopted with commendable speed in most of the Bank's countries of operations. It remains now for the institutions responsible to implement them effectively, which requires significant strengthening and training of their staff. Regulatory authorities, especially banking regulators, require increased numbers of trained staff to ensure a prudent and healthy expansion of the private financial sector and also to avoid the threat of systemic collapse or set-backs through financial imprudence or malfeasance.

**Bank involvement**

The Bank's approach to financial sector development combines an emphasis on the promotion of the financial sector, mainly through the establishment of private intermediaries, with assistance to public sector institutions which are responsible for the supervision and regulation of their activities. A top priority is the identification of the financial intermediaries in each market which meet or approach acceptable standards of credit assessment, monitoring and control. The Bank will work actively, but selectively, with financial intermediaries paying particular attention to management expertise and staff quality. The Bank's operations in the financial sector will be directed toward identifying appropriate intermediaries which can best meet the needs of small and medium-sized enterprises in the private sector while ensuring healthy financial sector development.

The expansion of private ownership of financial intermediaries can be achieved in three ways: (i) the higher growth of existing privately owned banks through better client services and superior performance relative to existing public sector banks; (ii) the establishment of new banks in the private sector; and (iii) the privatization of existing public sector institutions. The Bank will explore all three options. Regarding potential investment in new, or existing banks,
the Bank will secure the involvement of strategic partners in the private sector to provide the management expertise that is essential for profitable operation. The criteria for direct Bank support to financial institutions, whether equity investments or loans, are that lending decisions are based on strong credit assessment capabilities, that the management and staff are of proven quality, that financial and operational performance meet acceptable standards and that the institution has a credible business plan.

Other financial institutions such as insurance companies, pension funds, venture capital companies, leasing companies, housing finance institutions and savings banks, which are required to provide a broad range of financial services needed in a modern economy, will also be assisted on a case-by-case basis. Because of the uncertain status in some countries of title to land and other property, there may be particular potential in the area of leasing, provided tax and accounting rules can be established to allow the successful operation of leasing companies. Insurance and pension fund activity will need to be considered jointly with existing social security programmes.

The development of primary and secondary markets for securities has important linkages with the financing of government deficits, indirect mechanisms of monetary control and privatization strategies, which offer citizens tradable securities in privatized companies. Stock markets are also an important indicator of a listed company's value in an environment where valuation of assets is problematic. The Bank is exploring ways and means of supporting securities market development ranging from technical assistance to direct participation in the markets to facilitate local currency operations by the Bank.

In December, the Bank approved the establishment of a Regional Training Framework, to be administered by the Bank and executed in cooperation with the Japan Centre for International Finance (JCIF). Two projects in the Soviet Union in the areas of Government Securities and Commercial Banking were approved. Various other projects have been developed and are under consideration for implementation in 1992.

Privatization

The emergence of large private sectors in the countries of operations is fundamental to successful transformation into market economies. Growth of the private sector will depend on the expansion of new private firms, as well as on the privatization of existing assets. Based on the limited experience to date, there is reason to believe that the key to private sector development is the expansion of new enterprise, based on individual entrepreneurial initiative. But as this growth process will take time, privatization is a necessary means to boost the growth of the private sector.

This transfer from the state sector to the private sector not only increases the size of the private sector but is often the only way to salvage state enterprises. Privatization of state enterprises is essential both for the improvement of enterprise efficiency and for decoupling business and political decision-making. At present, enterprises operate without well-defined owners, as the state does not exercise its property rights.

Accordingly, management has neither consistent objectives nor appropriate supervision which might emerge through profit-motivated owners asserting their property rights. Without appropriate incentives, enterprises ignore the interests of their customers and the economy no longer adjusts what it produces as people's demands change. Without appropriate incentives managers and workers ignore the interests of their enterprises, and eventually the whole economy becomes dysfunctional. Also, state-sector managers are less able - and less inclined - to resist worker pressure for wage increases, particularly as wage decisions are not the result of a decentralized bargaining process. In turn this can lead to inflationary tendencies as governments face political pressures.

Despite these arguments, a proportion of state enterprises will, and should be, retained by the state. However, some degree of commercialization should be introduced to make retained state enterprises more responsive to market signals, such as the prices of inputs. Such commercialization can also act as an intermediate step for enterprises to be privatized in the medium and long-term.
To give an idea of the magnitude of the task in the countries of operations, it should be noted that in no country of the region does the public sector account for less than 60 per cent of value added, while in no OECD country does it account for more than 20 per cent. Typically, at least 40 per cent of activity will have to be transferred to reach OECD levels. Another striking measure is the sheer number of state-owned enterprises: for example, over 8,000 medium to large enterprises in Poland and some 700 owned just by the Moscow municipality. Nowhere in the world does an equivalent situation exist, and although we can draw on the previous experience of other countries, the techniques used here should be entirely new.

Current situation and recent developments

Most countries of operations have established, or are in the process of establishing, a legislative and administrative framework for privatization. Privatization tends to be treated differently for small and large enterprises.

For the privatization of small units, public auctions have been highly successful. For example, in the FSFR, over 15,000 small units were auctioned in 1991. In Poland, approximately 60,000 small units were leased or sold to the private sector in 1990 and 1991, and 70 per cent of retail trade is now in the private sector. In Hungary, a similar auction process is under way. Bulgaria is making some progress in privatization of small units in trade, services and tourism. In Romania, the process for divesting small assets of commercial companies, such as small shops and restaurants, has been started under the supervision of the National Agency of Privatization. In Russia, laws have been proposed for the auction of most small assets, and some auctions have taken place in St Petersburg. In Moscow, the local authorities favour direct sales to minimize the displacement of the existing workforce: the situation with respect to the Russian authorities still requires clarification. Other nations and republics including Latvia, Armenia and Kazakhstan, are making progress in selling small assets.

Privatization of agriculture has encountered substantial obstacles, except in Poland, where agriculture had remained predominantly private under the communist regime. Similarly, privatization of housing proceeds slowly because of political implications of the increase in the cost of rental housing necessary to induce private purchase.

Nevertheless, privatizing the housing sector will be key to achieving labour market mobility, thereby helping to overcome transitional unemployment. The privatization of large, state-owned companies is proceeding more slowly than initially expected. Hungary has chosen traditional methods for privatization, typically via trade sales supervised by the State Property Agency, and initiated at the enterprise level. The CSFR is using a multi-track approach, based on enterprise developed privatization projects and involving possible equity distribution to citizens via a voucher scheme. Poland is also pursuing a multi-track approach, which includes trade sales, public offerings and the setting up of privatization funds managed by professional fund managers, involving the distribution of ownership to citizens via vouchers. Romania has developed a similar programme, but with a smaller number of funds and greater reliance on state-administered trade sales. Russia is developing a bold programme of privatization, the details of which are still under discussion. Amongst the other CIS republics, the Ukraine and Kazakhstan are considering vouchers, Armenia has privatized three quarters of its land and most of the other republics are initiating privatization of some kind. The Baltic states are trying different approaches: Estonia has launched a pragmatic programme of management buyouts and trade sales, Lithuania has an ambitious coupon programme and Latvia is still finalizing its approach for larger scale enterprises.

Privatization of large companies has proceeded slowly, inter alia, because of: ill-defined property rights (including restitution); administrative bottlenecks (including uncertainty over areas of competence); high restructuring costs involving enterprise balance sheets, labour reorganization and operational restructuring; the low level of domestic savings; and a scarcity of management resources. There are also important issues raised by demonopolization, vertical de-integration and restructuring.

Some valuable lessons can be drawn from experience so far.
It is important to deal with privatization within the broader context of the enterprise sector as a whole. Most medium to large enterprises in the countries of operations need restructuring, and privatization should be regarded as the main avenue for this. But, of course, not all enterprises will or should be privatized, even in the long term. Western European economies have matured over long periods and are still evolving through careful mixes of state and private ownership. Therefore, the decision to restructure first, or privatize first, can only be decided on a case-by-case basis.

Similarly, on the question of monopolization, while this might be necessary before some privatizations, some ex-monopolists are increasingly exposed to international competition and domestic competition from greenfield competitors. It would sometimes even be unwise to break up a natural monopoly if this would entail a complex reconstruction and where the potential abuse of monoply power can be appropriately regulated.

The employment impact of privatization and its attendant restructuring is being factored in more and more to the privatization equation. While an understandable concern, the maintenance of employment is often in conflict with the overall objectives of the privatization process. The Treuhandanstalt has demonstrated that in demanding job guarantees it is willing to provide a trade-off in terms of reduced value. The recognition of this trade-off will be important for successful privatization throughout the countries of operations.

Generally, government policy statements and announcements tend to contain conflicting objectives. Experience to date dictates that one objective is overriding: helping the enterprises to compete and survive. This is the main reason why privatization must take place speedily. If a caring owner does not take control, numerous enterprises, even potentially viable ones, will not be able to face the rigorous market environment. The extensive liquidations this would entail would lead not only to widespread social displacement, but also to enormous losses of capital. Therefore, massive and urgent technical assistance is necessary to carry out the privatization as rapidly as possible, and finance is required to keep the enterprises alive in the interim.

In such an environment there is not much time to develop grand schemes. Excessive emphasis on building up an administrative machinery and specifying detailed rules to govern the privatization programmes has led to long and difficult decision-making and legislative processes for each major transaction. Meanwhile the enterprises themselves are entering a crisis stage.

Often potential buyers are put off by the complexity and uncertainty of the process. Many of the privatization negotiations taking place have collapsed because of bureaucratic difficulties. These are not just administrative problems: they are caused by the long round of concessions and requests required by all the various interested constituencies. The end result is often not merely that the investor decides to set up a brand new venture, wasting the potential savings of using an existing enterprise and improving it. The experience can lead the potential buyer not to invest in the region at all.

Efficient decentralized approaches must be adopted. The main approaches would be to permit large privatizations to be initiated and processed by enterprises themselves and by prospective investors, with control by the state limited to matters of valuation and transparency, and to use a larger number of diversified intermediaries in addition to a centralized state agency and its branches, such as state holding companies, restructuring and privatization funds.

If privatization is to be initiated, and mostly carried out, in the field by investors and enterprises, then it will be necessary to share experiences of, and techniques used in, actual privatizations as well as experience of unsuccessful attempts and schemes. Shared experience about the management/employee buyouts and related financing techniques used by the Treuhandanstalt in Germany would, with proper tailoring, be reproducible on a larger scale in the countries of operations. Early experience of different methods of selling small assets should be analysed and the most successful elements replicated. A body of knowledge exists of the various financing schemes required to compensate for the lack of domestic resources. In these areas and others,
the Bank will make an effort to disseminate information systematically. A project to launch a privatization information base is being developed for the purpose.

**Bank involvement**

The nature of the Bank’s involvement depends on how far the country concerned lies along the path of privatization. In countries where the process is under way and proceeding reasonably successfully, the Bank is involved as a financier and core owner of newly privatized companies. In countries just beginning to create a framework, the Bank is acting as an adviser to the government on the design and implementation of its privatization plan, basing its advice on practical transaction work in the country itself and applicable experience from the other countries.

In countries with a functioning privatization framework, no matter how imperfect, the Bank is assisting the emergence of private enterprises and supporting their growth through lending and investment. The approach is to stress privatization methods that encourage clear control and corporate ownership. The most viable companies or sectors can be privatized quickly through trade sales to committed industrial partners.

Some state enterprises will be fully privatized, but many enterprises are also expected to be privatized through the entry of a new investor who will dilute state ownership, thereby recapitalizing the enterprise and facilitating urgently needed investments to modernize the enterprise and change its product mix.

The Bank acts as a catalyst to privatization by helping viable enterprises attract such investment. Seven of the 14 transactions approved by the Board in 1991 have involved the privatization of either an ongoing business or some of its assets. As the recent examples of Bank involvement in individual Czech privatization transactions show, the Bank can act as a facilitator of a privatization by taking a carefully measured core ownership stake, with the remainder taken by a committed trade investor and local institutions.

The Bank also assists governments or relevant agencies in organizing and implementing entire privatization programmes, focusing in particular on their initial phases. Generally however, in providing such advice and technical assistance, the Bank has a transaction-oriented approach. The intention of the Bank is to rely as far as possible on external advice from investment banks and specialized firms, financing such services, where possible, out of its Technical Cooperation Funds Programme. So far some 50 experts have been involved in the six largest assistance programmes actively taking place.

In Hungary, for example, the Bank is helping to assess the viability and define the business plan of a ‘turnaround company’, which will buy potentially viable businesses from the state which are in need of restructuring and investment in order to become attractive to bidders. Support has been provided as well to the privatization programmes of Bulgaria, Macedonia and Romania.

The Bank was involved in initial discussions on the mass privatization scheme in Poland. Like all such schemes it has had a long and complicated nurturing period, but now appears to be well conceived and worthy of support.

In the City of Moscow, the Bank is assisting in the formulation and implementation of a privatization programme for roughly 16,000 small businesses and 700 medium to large enterprises, controlled by the city. The experience gained from the immediate processing of three ‘pilot transactions’, including a consumer plastics manufacturer, a stone-processing factory and a gelatin manufacturer, is now being applied to designing an overall scheme that can deal with the large numbers of enterprises involved in a realistic and workable way. At the request of the Mayor of St Petersburg, the Bank has taken a similar approach aimed at developing a privatization programme for the city’s medium to large enterprises. As in Moscow, three pilot transactions are under way including a consumer products manufacturer, a confectionery manufacturer and a chain of department stores.

The Bank and the World Bank Group are jointly organizing a large scale privatization advisory project for the Russian Federation, and the Bank has already been able to bring the Moscow and St Petersburg experience to bear on a better definition of various elements of the overall Russian programme. A project management unit, to be situated within the Russian State Committee for the Management of State Property, is currently being staffed to launch this project.
The Bank will continue to refine its responses, but at this stage, it finds the 'empirical' approach to be the most productive, as only the direct experience of negotiating with a worker collective, of trying to get a transaction approved or of offering investment opportunities to risk-averse investors, will give an insight as to what changes in the framework are most urgent. The Bank will also recommend what needs to be done institutionally within the relevant governments to facilitate implementation of a large volume of transactions. It believes that such a pragmatic approach, based on experience, is the most realistic way to proceed.

**Foreign direct investment**

**Current situation and recent developments**

Foreign direct investment plays a strategic role in central and eastern Europe and the former Soviet Union which goes beyond the flow of capital. The operational commitment on the part of trade investors also brings a transfer of technology and managerial skills, helps introduce new standards of product quality and operational efficiency, and can open access to new markets. Privatization through direct investment by an industrial partner is often the most expedient way to restructure a company and bring it to a level of operational efficiency which will enable it to survive in the new competitive environment.

While much hope is pinned on the generation of a substantial flow of direct investment and while the level of interest among potential industrial investors is high, the actual flows are disappointingly low. As of October 1991, it is estimated that the aggregate foreign direct investment earmarked for central and eastern Europe and the former Soviet Union as recorded in registered joint venture and investment proposals had reached approximately US$ 13 billion, representing over 30,000 investment projects. The actual dollars disbursed and number of ventures which are operational are, however, at best 40 per cent of the recorded figures. This estimate represents less than five per cent of the region's estimated 1990 net external debt.

On an annual basis the estimated investment flow represents less than a fraction of a per cent of the region's estimated GDP. These figures suggest that concerns over encouraging too much direct investment are premature and that much still needs to be done by the host countries to create a more attractive environment for investments, starting with a streamlining of the governmental approval process and the reform of the legal and fiscal systems. Foreign direct investment must reach a more significant level. However, it should not reach a level and concern sectors where foreigners own the choice assets and the integrity of the local economies is lost.

EEC and EFTA countries are by far the greatest investors, accounting for figures ranging from 55 per cent to 80 per cent of the foreign capital committed, depending on the country. The United States has participated in approximately seven per cent of the projects, and their capital contribution has been highest in the former Soviet Union and Hungary, estimated at approximately 11 per cent. Canada and Japan have invested less. Cross-border investment from central and eastern European countries themselves has accounted for approximately four per cent of the projects and as much as 13 per cent of the capital inflow in the case of the CSFR and nine per cent in the case of the former Soviet Union.

The former Soviet Union has received the largest capital commitment from foreign investors, earmarked, in large part, for the natural resource sector. But only a small proportion of the amounts committed has so far been invested. Otherwise, Hungary has been to date the most successful country in attracting foreign direct investment in excess of US $1 billion in 1991 alone. Increasingly, the CSFR is attracting investors. Now that the privatization programme is moving ahead, the CSFR may this year surpass Hungary. The level of interest to date in Poland as well as the other countries in the region has been disappointing.
The investment climate is and will remain a difficult one: local economies are in depression, financial and physical infrastructure is deficient and the legal, administrative and fiscal systems are at best uncertain. Yet central and eastern Europe and the former Soviet Union offer investors two main strategic advantages: the proximity to western Europe and the perspective of one integrated market of 700 to 800 million people, and an educated and technically proficient labour force. The experience of most Western industrialists who have been active in central and eastern Europe, Russia or Ukraine shows that, with appropriate incentives, the workers perform efficiently and diligently and that their level of technical skills is equal to, or higher than, that in many Western countries. Investors who are willing, notwithstanding the short-term risk, to invest in the long-term potential of the region should be encouraged. The role that the Bank wishes to play in this respect is substantial.

Bank Involvement
Many of the Bank’s first projects contribute directly to encouraging direct investment. In 1991, seven out of a total of 11 operations in the private sector involved foreign industrial partners, all four others involved foreign investors. The capital committed by the Bank was leveraged four times by the commitments made by other foreign investors and lenders. The Bank’s involvement in these projects acted as a catalyst without which the investments either would not have occurred or would have been severely scaled down. By sharing the risks with potential investors and by providing some shield from the political uncertainties, the Bank hopes to multiply the number of investors and amount of capital committed to the region.

Transport
Current situation and recent developments
Recent events in the region resulted in dramatic changes within the transport sector. Although there was a significant decline in all land transport movements, the most severe reductions affected the railways, previously the backbone of the socialist networks. Other important changes related to the direction of traffic flows. Since the collapse of CMEA trading arrangements, there has been a drastic reduction in traffic between central and eastern European countries and the former Soviet Union, an almost equally dramatic increase (though smaller in absolute terms) in flows between central and eastern European countries and Western Europe and lesser, but still substantial, reductions in traffic between the central and eastern European countries themselves. Institutional changes were also dramatic. Most forms of transport which were centrally organized are now being privatized or split into smaller administrative units. The changes have produced disarray and confusion, compounded by additional handicaps of an old-fashioned organization, outdated technology and inadequate infrastructure.

Overall accessibility to transport services is generally lower in central and eastern than in western Europe, and much lower in the former Soviet Union. Personal mobility is below that of higher income countries, as the effects of much lower levels of car ownership are only partially offset by more travel by public transport. In 1991, the Bank’s countries of operations generated higher volumes of freight per dollar of national income than western European countries. As a whole they also relied to a greater extent than most other countries on railways and to a far lesser extent on roads, for the movement of both freight and passengers.

Although the environmental impacts of transport in the Bank’s countries of operations are not as serious as in Western Europe, they are potentially of concern. The relatively low levels of car ownership imply that the transport contribution to pollution is rather less than in other European countries. Poorly maintained vehicles, however, particularly diesel engine buses, contribute to high levels of pollution. In addition, the use of lead additives in gasoline is still prevalent practice in these countries. Increased demand for transport services could lead to a rapid increase in urban air pollution.
Future prospects

The move to market economies in central and eastern European countries can be expected to have major repercussions on transport industries, in particular with some shift away from heavy capital goods industries towards lighter consumer goods industries, services and foreign trade. The price of energy will rise towards international levels, encouraging energy efficiencies and further reducing transport demands for coal and petroleum. The shift towards high-value light manufacturing will increase the demand for higher quality transport services in terms of frequency, dependability and cargo security.

The demand for passenger services and higher standards of service is set to expand greatly, both because present quantities and qualities are abnormally low by world standards for given income levels and because per capita incomes and expectations are likely to rise. The demand for private cars is expected to expand dramatically throughout the region.

The anticipated changes in demand will, generally, militate against traditional rail services and favour higher standard services, including road and aviation. The decline in bulk traffic has already hit central and eastern European railways particularly hard. The prospects for rail transport capturing a significant share of the growing volumes of high-value freight are poor, as average haul distances in these countries are short and the railways, in general, suffer from obsolete organization.

Combined transport, whereby goods are moved across transport modes under the same documentation, has been totally neglected in central and eastern Europe and it is unlikely to play a major role in the future, despite efforts to stimulate its development. Central and eastern European countries have developed a system whereby the various forms of transport supplement one another instead of competing internally and this could form the basis for future development of combined transport. However, it will not be viable until road and rail traffic each independently achieve satisfactory standards of efficiency.

Supply responses

The transport means in much of central and eastern Europe will operate in a physical and economic environment increasingly similar to that of western Europe. Thus, assuming competitive policies are pursued, the outlook for long-term transport solutions in these countries should be similar to that in the West. The principal difference is that lower per capita incomes will depress demand for higher quality passenger services, although demand for private cars will soar unless constrained by government intervention. Road transport will assume a much greater importance and there will be a socially painful, but economically necessary, contraction of the railways sector. The exact form of the restructuring of the rail sector will depend on how competitive the railways are in the market, particularly for passenger services.

In the former Soviet republics, however, the long haul distances, heavy traffic volumes and the cost and service disadvantages of road transport will mean that the railways are uniquely positioned to compete with door-to-door road transport. In the Baltic states, there is a major question as to whether existing port facilities will continue to be utilized by Russia and the other former Soviet republics. Spatial and economic circumstances dictate that they should be, but political factors may militate against this. In passenger transport, aviation is likely to expand its role significantly for long haul passengers, while bus transport will continue to grow rapidly for short and medium distances. The natural role for rail passenger transport is for medium distance traffic, roughly in the range of 200-800 km, and for very high volume urban and suburban movements.

Institutional reform

The organization of transport in the Bank's countries of operation requires a number of radical reforms and sector-specific developments to enable it to meet growing demands for faster movement of both freight and passengers, and for improved quality standards.

Current initiatives to reduce the role of government in the former socialist countries hold significant potential pitfalls as well as benefits. A key danger is that the essential minimum role of government may be lost. Care will be needed to ensure that the public interest is protected in the planning and provision of
infrastructure, safety (air traffic control, road police and traffic management) and environmental protection. There are also compelling arguments for governments to retain at least a monitoring function, a research and analytical capability for assessing major trends in supply and demand, and a financial and user taxation role. There are many models from different countries from which to choose.

Barriers to competition are virtually non-existent in the road transport industry, fairly limited in water transport, still moderate in aviation but quite formidable in the railways sector. Virtually all that is required in the way of institutional reform of road, water and air transport are policy measures aimed at decontrol of market entry and exit, demonopolization (with a vigorous anti-trust/pro-competition stance in the case of water and air transport), deregulation of tariffs, economically efficient user taxes, and safety and environmental regulations and enforcement. With these measures in place, road, water and to some extent air transport modes can be expected to develop efficiently. Where inter-modal competition is limited - primarily in the former Soviet republics - particular efforts will be needed to create competing elements within the railways sector itself and/or exercise regulatory restraint on the monopoly powers of the railways.

For the railways, however, it will be essential for government to develop a programme to safeguard the public interest when introducing institutional reforms, particularly in the creation of internal competition in the sector.

**Investment needs and strategies**

The transport industries demand huge new investments and, at the same time, adequate resources for maintenance. Not all of these needs can be met at once. Governments will need to utilize all the instruments at their disposal to maximize the productivity of existing assets before undertaking new investments.

Proper pricing is vital. This will require the introduction of modern cost accounting and the careful structuring of user taxes, including congestion and pollution charges, so as to encourage both users and suppliers to adapt their behaviour to make best use of the existing infrastructure. Both demand and the requirements for new capacity should then be more manageable. Moreover, revenues from taxes on congestion and pollution can be expected to make a major contribution to meeting the enormous financing needs of the sector.

New financing instruments are also needed. For most of the twentieth century, provision of transport infrastructure has been predominantly a public sector function. In recent years, there has been a major revival of interest in concession financing, particularly for BOT (Build, Operate and Transfer) operations. BOT projects are not, however, easy to implement, especially in the absence of a sophisticated commercial and legal environment. Nonetheless, many countries will simply have no other option.

International equipment leasing has grown phenomenally in recent years. All modes of transport, save perhaps pipelines, have embraced leasing finance enthusiastically and recent major additions to the world’s capital stock, as well as fleet renewals, have been financed through leasing companies. The risk reduction associated with the mobility of equipment makes this a particularly suitable form of finance for use in central and eastern European countries and leasing companies are already active there.

**Bank involvement**

The Bank’s initial approach to the transport sector has four basic elements:

- a comprehensive view will be taken of the transport sector across all modes of transport,
- the principle that competitive markets provide the best opportunity for guiding the economies of both the East and the West will be supported,
- the development of transport networks guided first of all by economic priorities and technical efficiency will be promoted, and
- priority will be given to projects which contribute to the integration of Europe and to the enhancement of the environment.

One of the basic aims of the Bank’s approach to the sector is to upgrade the subsectoral planning capabilities of the various agencies dealing with transport. This will be achieved through the preparation of basic pre-investment and design studies by consultants and, more importantly, through well-designed training programmes targeted at the implementing agencies, technical institutions and local consulting firms.
The Bank, with its mandate to assist the private sector, will also play a significant role in enterprise restructuring and management. This will include assisting in the restructuring and partial privatization of railway, port and road transport enterprises. Management information systems for railways and ports, and cost accounting and tariff studies, will also be provided, emphasizing the balanced development of the transport system.

Highways A major backlog has built up in the rehabilitation and maintenance of highway networks. The Bank is concerned, therefore, not to over-emphasize the need for the development of new motorway schemes. There is also a need to increase efficiency in the use of scarce road maintenance funds through the introduction of pavement maintenance systems. Specific investment support could well be directed at relieving major bottlenecks in the main road corridors through the implementation of a staged approach to the development of motorway networks. For such schemes, the Bank will examine the possible use of BOTs or bond financing for toll facilities. Preliminary indications, however, show that, for most central and eastern European countries, competitive tendering with a view to obtaining the best possible construction contract could well provide the most attractive solution to toll road construction.

Road transport The road transport industry offers scope for the early development of private enterprise and it is one where the Bank's merchant banking expertise can be fully utilized, through the restructuring of existing enterprises prior to privatization, as well as in the sale of specific units or assets. Road safety programmes will also be developed as part of the assistance programme to the road transport subsector.

Railways Although railway traffic is now declining, the Bank may focus on the major need for selective rehabilitation and renewal of railway infrastructure and equipment, particularly to develop local capacity for the rehabilitation of locomotives and rolling stock. Railway projects will also seek to support the contracting out of other activities such as track rehabilitation, equipment maintenance and catering. Contract plans defining the respective responsibilities of government and railway, particularly in relation to pricing and cost-sharing arrangements for track renewal and maintenance, will be an important policy tool in the restructuring of railway enterprises.

Aviation In contrast to railways, aviation is a sector which is likely to expand greatly. Requirements for development stretch across the full spectrum of the industry: air navigation and traffic control, airports, aircraft and enterprise reform. The Bank has a role to play in all these dimensions, as well as in advising and assisting in the development of appropriate public policy regimes. The first priority will be to establish an overview of policy and investment priorities for the subsector in each country of operations, although some urgently needed investments, the economic priority of which is manifest, can be identified for immediate action.

Ports The Bank's emphasis will be on modernizing port facilities and adapting existing infrastructure to changes in shipping technology. The main objective will be to reduce port handling costs and sea freight rates, thereby lowering the cost of imports and making exports more competitive. Particular attention will be given to the development of a limited number of load centres for container and roll-on roll-off traffic in order to benefit from economies of scale in the growth of this type of traffic. As the ports constitute a key interface between transport modes, such projects represent ideal ways of focusing attention on transport logistics issues such as documentation and clearing procedures, and freight forwarding and support services. These are areas where there is also considerable scope for private enterprise and where the Bank's merchant banking expertise can provide support.

Urban transport Traffic management and vehicle emission issues will be addressed as part of urban development programmes rather than as stand-alone transport projects. However, assistance will be provided for urban transport through other transport projects such as by-passes and/or urban throughways, support for suburban railway services and the restructuring of bus enterprises serving urban areas.
Telecommunications

Current situation and recent developments

The telecommunications sector in central and eastern Europe confronts two main challenges: an urgent need to upgrade existing infrastructure in line with market demand and best practice in other countries, and the need to adapt to new commercial practices and adjust to a competitive environment. These challenges need to be addressed simultaneously against a background of scarce resources and an uncertain regulatory structure.

Current telephone penetration levels in central and eastern European countries range between 9 and 22 direct exchange lines (DELS) per 100 inhabitants, well short of the OECD average of 40 per cent DEL density. At a cost of US $1,500 to $2,000 per line, the investment envelope that is required to reach the countries’ target of 30 per cent DEL penetration by the end of the decade amounts to US $38 billion to $50 billion. This implies a compounded annual investment growth rate of 11 per cent, nearly twice the rate in the period 1980 to 1990. Much of the current infrastructure, however, needs upgrading or replacing. The total bill in the 1990s is therefore likely to be one-and-a-half times as large - up to US $75 billion. This is both a formidable financial challenge and an unprecedented organizational and implementation challenge for the governments and the post, telegraph and telephone organizations (PTTs) of central and eastern Europe.

While the provision of telecommunications services commands healthy margins, pay-back periods for large public infrastructure projects are long. In addition, experience shows that the ability to manage the various parts of the business is a crucial factor. Faced with a widespread scarcity of financial and human resources, the countries of central and eastern Europe have begun to formulate their priorities and strategies. Little or no differentiation between various services and customer segments was made in past telecommunications investments. A broad consensus now exists on the need for selective and economically sound investment strategies. The first wave of ‘virtuous’ investments will pave the way for further infrastructure development from retained profits. At the same time, the private sector is poised to play an increasingly important role in the transformation of the sector.

Priorities

Self-financing capacity is a key factor which will influence the choice between projects competing for public borrowing. Given that telecommunications revenue per inhabitant in central and eastern European countries amounted to only US $25 in 1989, the cash flow generated from existing operations is insufficient to meet adequate self-financing levels (70 per cent according to western experience). Consequently, there is likely to be a substantial investment gap which can only be filled by borrowing or by direct foreign investment.

In practice, central and eastern European countries are opting for a mixture of funding from international development institutions and direct investment by (foreign) private operators. The degree of liberalization, the extent of privatization, the type of participation open to private investors and the regulatory regime significantly affect the range of options available.

It appears likely that, if funding and expertise is to come from international development agencies (the Bank and others), which employ commercially oriented lending criteria, and from private sources, central and eastern European governments may need to trade off certain long-term objectives in order to satisfy immediate requirements.

The key trade-off is likely to be between satisfying the universal telephone service obligation and satisfying particular user groups’ most urgent needs. Telecommunications operators (whether public or private) are inclined to favour revenue-intensive customers in the first phases of network deployment and modernization. High-usage subscribers will probably be the first ones to benefit from the adoption of digital technology. This should alleviate congestion on existing networks, enhance the level of service, free capacity for less intensive users and thus prolong the economic life of old (analog) plant.
Less intensive users would gradually join the new network subsequently. Furthermore, initial investments will most likely be directed at adding new services (such as international gateways and digital trunk overlay networks) and functions to the network, rather than merely upgrading old analog POTS (plain old telephone service) lines to digital facilities.

**Regulatory requirements**

It will be the regulator's responsibility to ensure that sound commercial practices are not at odds with public welfare objectives. However, since telecommunications infrastructure development is to take place within a relatively short period of time and public borrowing alone is impractical, the regulatory regime is likely to be liberal, perhaps much more so than in most western countries. A minimum amount of regulation consistent with meeting economic and social objectives will entail:

- a phased strategy aimed at satisfying universal service obligations through mechanisms that would ensure that a portion of the proceeds from profitable segments be earmarked for developments in less attractive user segments.

- structural tariff adjustments to safeguard profitability,
- fair and efficient market entry rules, and
- an obligation to provide competitors with cost-based interconnect prices for access to the public network.

**Institutional reform**

Infrastructure and market growth will require major structural reforms. These are already under way in most countries, involving:

- the introduction of arm's length relationships between governments and PTTs,
- separation of posts and telecommunications,
- separation of regulatory and operating functions,
- reduction of tariff cross-subsidies and the introduction of cost-based pricing,
- restructuring ('corporatization') of PTTs,
- introduction of competition in selected service segments, and
- privatization of government-owned PTTs.

The scope of the reforms has been broad and the timetable ambitious. Critical issues remaining include demonetization, ownership and control and sectoral separation.

**Demonetization**

Liberalization is expected to yield faster growth, enhanced service quality standards and financial discipline. However, competition in the global telecommunications market has been limited to the provision of customer premises equipment and certain value-added services. With a few notable exceptions (Japan, UK and US), POTS provisioning is still under PTT monopoly in most western countries. Selective competition measures might take any of the following forms:

- allowing a second or third fixed-link operator for selective POTS,
- introducing resale and encouraging private networks, and
- encouraging yardstick competition from enhanced services.

**Ownership and control**

In addition to the introduction of competition, the promotion of a more entrepreneurial form of management is crucial. These changes can take many forms, ranging from relatively small structural and operational changes through to privatization and the large-scale introduction of private capital and modern business practices. The introduction of new capital does not, in itself, increase efficiency. What are important are the skills that potential private shareholders are likely to bring to operations. Options include consultancy services, management contracts with or without ownership clauses and outright ownership.

Trends can already be detected in favour of collaborative arrangements rather than absolute self-reliance. However, as privatization is not necessarily accompanied by demonetization, subscribers will in due time need protection from private monopoly operators who might seek excessive returns on their investments.

**Sectoral separation**

The dismantling of PTT monopolies is no guarantee that the benefits to be gained from the implementation of a market economy will be realized. The creation of smaller, more focused entities, in place of the previous vertically-integrated PTTs, however, will ensure greater competition. An immediate advantage of this process is that the smaller entities are easier to privatize and to control, but this benefit must be balanced by the cost and time involved. For instance, a few central and eastern European countries are
considering splitting the PTT into several local operating companies with a national operator providing long-distance and international services. Given that operating margins are, by and large, much more attractive in long-distance and international services, care will be needed to ensure that local operating companies are economically viable when working under conditions of competition and regulation. Otherwise, inappropriate 'split up' strategies might defeat the (already hard to achieve) social goal of universal telephone provision, since the bulk of local telephone usage is associated with the residential sector.

**Bank Involvement**

Recognizing that ubiquitous telecommunications services and the free flow of information are essential for economic growth, the Bank will actively support and promote the effective development of telecommunications infrastructure and services across the central and eastern European region. Loans have already been made for an enhanced digital network in Moscow, cellular telephones in Poland and telecommunications systems in Hungary and Romania. Discussions are also underway for telecommunications projects in Belarus, the CSFR, Estonia, Latvia and Lithuania, as well as for technical assistance in Albania.

The Bank will encourage competition through the greater participation of the private sector in the various telecommunications services, including those currently run by public monopolies.

Priorities in these areas will have to be formulated. Given the urgency of needs and the long time-scale from inspection to implementation, investment projects cannot be delayed to await structural reforms of the economy and the telecommunications industry itself. Reforms will need to be anticipated and investment projects tailored accordingly.

**Energy**

**Current situation and recent developments**

As a result of the previous CMEA arrangements, central and eastern European countries were overwhelmingly dependent on oil and natural gas imports from a single supplier, the former USSR.

This reliance, based on artificially low prices, gave a false impression of cheap and abundant energy supplies, stimulated the extensive and inefficient use of energy resources and encouraged the development of energy-intensive facilities, such as oversized refineries, heavy industry and petrochemicals factories. The lack of energy conservation incentives, inappropriate price structures bearing no relation to supply or production costs or to international market prices, adherence to big projects using outdated technologies and the predominance of low calorific coal were inherent features of the centrally planned economic system.

These economies consume more than double the amount of energy to produce one dollar of value added than western European economies.
In the long-term, there is considerable potential to reduce energy intensity. In addition, some savings could be made in the short-term through pricing reforms and improvements in maintenance and plant operations.

As a consequence of central planning, the energy sector as a whole is highly integrated, both horizontally and vertically. The absence of private ownership and the lack of clear managerial responsibilities have resulted in inefficiency and a low level of foreign investment.

Given the absence of any proper regulatory framework and limited access to clean technologies, energy sector activities in central and eastern European countries and the former Soviet Union have had a serious impact on the environment. Problems include extremely high emissions of carbon and sulphur dioxide, discharges of saline mine water into rivers, the devastation of great tracts of land through large scale opencast mining and a steady increase in the number and size of waste heaps.

The breakdown in CMEA trading patterns and the move towards international prices of imported energy, which was not accompanied by corresponding increases of domestic currency prices, have resulted in energy supply security being a major objective of central and eastern European governments and for those former republics of the Soviet Union poorly endowed with energy resources. Reducing these dependencies to prudent levels can be achieved through pricing reform and policies aimed at the diversification of supply options and at energy savings.

In parallel, existing energy infrastructure will require rehabilitation and modernization to make it more reliable and efficient, and to access new sources of supply. Amongst the energy-producing republics of the former Soviet Union, the chief issues are reversing declining production of oil, gas and coal and easing bottlenecks sharply restricting the transport of fuels.

**Subsectoral overviews**

**Natural gas** Demand for natural gas is expected to increase, especially in power generation, due partly to environmental concerns. In the light of stagnating gas output from the former Soviet Union, this forecast increase underlines the need to reduce vulnerability to supply disruptions through:
- the development of indigenous natural gas exploration and production activities and the production of coal bed methane which has major potential, for instance, in Poland, and
- the diversification of imports. However, gas supply to central and eastern European countries from suppliers such as Norway, the Netherlands, Algeria or Iran will require substantial additional investments.

In order to adapt existing energy infrastructure to new potential sources of gas, as well as to integrate existing eastern and western European energy networks, the Bank's countries of operations have been considering various options, including a gas pipeline via Turkey to central Europe. Efforts are under way to transform the powerful Czechoslovakian Transgas trunkline system, connecting the former Soviet Union's gas fields with western European consumers via the CSFR, into a joint stock company with possible later privatization. The intention is to facilitate technical rehabilitation, to increase the pipeline's capacity and to diversify supply sources by establishing links with pipelines in western Europe.

**Electricity** Except for the former Soviet republics, central and eastern European countries as a whole are deficient in electricity. Until recently, shortfalls were covered by imports from the former USSR, either on the basis of power purchase or power plant sharing agreements. In some central and eastern European countries, nuclear power fulfills a significant portion of electricity needs.

To meet future electricity demand, central and eastern European countries and the former Soviet republics will have to reduce transmission and distribution losses (which are high by international standards), rehabilitate and expand electricity grids, upgrade existing generating capacities and, in certain cases, construct additional capacity. Operating efficiency will also need to be improved. Given the uncertainty of export capacity from the energy-producing former Soviet republics, the desire of countries to diversify energy supply sources and growing environmental awareness, increased interconnection between western and eastern networks may offer a long term, cost-effective solution. Strengthening transmission, however, will depend upon improvements to the power quality and reliability of existing systems.

Given the available nuclear capacity and, in many cases, the lack of immediately available alternatives, nuclear energy will continue to play a
role in the region. Two areas of particular concern are the safety of existing installations and fuel cycle operations. There is an urgent need for external technical assistance to respond to problems posed by some of the older technologies still in use, and to support the efforts of regulatory authorities to lay down the most advanced internationally accepted nuclear safety requirements, covering the operation of existing stations, decommissioning and long-term safe disposal of nuclear waste.

International organizations and national agencies are engaged in intensive dialogue and cooperation in this field. This is a new and major feature of the reform process.

Oil The domestic instability of the energy-producing former Soviet republics, together with reduced oil production and much higher oil prices resulting from the dismantling of the previous CMEA arrangements are challenging the fragile economies of central and eastern European countries, and former Soviet republics with an energy deficit. The curtailment of oil deliveries from the energy-producing former Soviet republics (expected in 1991 to be about 36 per cent of actual oil supplies in 1990) has resulted in an enforced search for alternative energy sources and routes. Some countries have already succeeded in diversifying their oil import portfolio. Others are constrained by technical (e.g. limited infrastructure) and financial factors.

Various options to adapt existing infrastructure to new supply sources are being examined. The CSFR, for example, is planning connections with the western European oil and gas pipeline system, linking the Czech refineries to the Transalpine pipeline via Germany and the Slovakian ones to Austria, by 1993. An Austria/CSFR project proposes to link an Austrian refinery with a refinery near Bratislava by means of a 60km long pipeline. This pipeline would also connect the CSFR to the Adria-Vienna pipeline, to the Trieste oil terminal and to the Mediterranean oil market.

Refineries in central and eastern European countries and the former Soviet Union were built to process Soviet oil and are extremely limited in their production potential. Most are now old and outdated. They are uneconomic and inefficient by western standards:

- available refining capacity exceeds demand,
- the infrastructure to transport products from and to external markets is very limited,
- the configuration of facilities is not flexible enough to allow the processing of an extensive variety of crude oils, and
- adjustment of production capabilities in line with the demand for a wider range of higher quality products, meeting more stringent environmental standards, will be difficult.

Coal Coal is a very significant indigenous resource in several central and eastern European countries and in Russia and Ukraine. It will continue to be a predominant basic fuel in the region for some time. However, transport bottlenecks are severely impeding coal supplies for power generation in some of the former Soviet republics. Moreover, in the longer term, the trend towards increased energy efficiency, combined with price liberalization and the enforcement of new pollution standards, focused especially on emissions, will make the coal subsector uneconomic in many areas. Restructuring will have considerable social implications.

Bank involvement

Given the complexity of the issues in the region's energy sector and the great need for investment, the Bank has undertaken to establish a framework within which specific investments and policy reforms can be promoted and implemented.

The Bank will focus its investment operations (at least for the next few years) on improving the efficiency of existing supply facilities, completing existing high priority projects and promoting conservation. Such operations will be highly economic, often will have strongly beneficial environmental impacts, and can be implemented relatively quickly. Typical operations will cover priorities such as bringing existing oil and gas reservoirs into production, repairing natural gas pipelines, rehabilitating power transmission systems, upgrading district heating systems and completing power stations under construction. Particular emphasis will be given to projects which assist countries to increase energy exports, and which provide additional energy supplies for Europe.

Operations involving new projects will probably be limited to the provision of energy infrastructure on an emergency
basis (for example, following serious disruption to traditional sources of supply), projects to strengthen the regional interconnection of energy infrastructure, and private sector projects which promote liberalization of supply and the injection of foreign capital and management expertise.

The Bank played an active role in the negotiations leading to the establishment of the European Energy Charter, signed in the Hague on 17 December 1991. Its involvement has continued with the secondment of staff to the provisional Charter Conference secretariat. The objectives of the Charter coincide entirely with those of the Bank.

**Municipal development**

**The Municipal Development Initiative**

The cities of central and eastern Europe and the former Soviet Union have an important role in the transition of their countries to democratic, pluralistic market economies. Decentralization and the empowerment of local governments and populations constitute a major aspect of reforms currently under way. Decentralization of municipal services, including water supply, housing, urban transport, heating and environmental protection, is placing complex regulatory and management responsibilities on local governments. Decentralization is also associated with a significant transfer of land assets and public enterprises from state to local government level. Local governments will therefore have an increasingly crucial role in economic and social development in coming years.

In recognition of this role and of the important financial and infrastructure issues confronting cities in the countries of operations, the Bank has launched the Municipal Development Initiative (MDI). The MDI has been designed to support directly, through project financing and technical assistance, the close links between urban infrastructure, municipal services and local government. It recognizes that effective development and management of urban infrastructure require an appropriate local government capacity and financial management framework.

The operational instruments within the MDI include:
- financing of urban infrastructure projects,
- pre-investment work to advance the preparation of specific urban infrastructure projects,
- technical assistance to increase the efficiency of municipal services and to support the development of local government management capacity, and
- support in the definition of the national institutional and financial frameworks of local government.

Specific MDI technical assistance and project-related work activities are under way in several cities, including Bratislava, Budapest, Gdansk, Moscow, St Petersburg and Warsaw. MDI activities are also being defined elsewhere. Particular emphasis is being placed on local participation and commitment and on the establishment of a solid operational relationship. A number of activities aimed at strengthening the resources and financial instruments available to local government are under way, concerning the water, urban transport, heating, housing and solid waste management sectors. Work is also under way on the development of appropriate institutional and financial frameworks for municipal services.
Environment, Including the Impact of the Bank's Activities

Current situation and recent developments

Environmental deterioration in central and eastern Europe is of wide-ranging concern. Existing scientific data on the state of the environment are too limited to provide a reliable and comprehensive picture, but there are several indications of a worrying and deteriorating situation in many parts of the Bank's countries of operations. Human health, the man-made environment and natural systems are threatened by the consequences of previous and present day economic activities. Large areas within and outside the region are adversely affected. Examples of environmental disaster include the radioactively contaminated region around Chernobyl, and the Black Triangle on the borders of Poland, the CSFR and Germany, which is grossly polluted by the extraction and combustion of lignite.

State ownership and central planning emphasizing rapid, heavy industrialization, extensive resource extraction and large scale economic units, was the result of ideological rather than efficiency or welfare objectives. Neglect of the real costs of energy generation, resource utilization and damage to natural systems created an industrial structure in central and eastern Europe which is not sustainable, either from an economic or an ecological perspective. Low productivity, unemployment, poverty and poor health are now seen as inevitably linked with pollution, occupational and community health risks, deforestation and the extinction of species.

Although there are some similarities, environmental risks in central and eastern Europe are more serious than those which western countries faced during their industrial expansion. The scale and extent of potential hazards associated with industrial technology have grown greatly during the twentieth century but contrasting central and eastern European economies have little domestic capacity to cope with these problems. Environmental awareness has been underdeveloped in an era of economic shortages and of undemocratic politics.

Resource utilization per capita in central and eastern European countries is generally below that of western societies. The populations of central and eastern Europe enjoy less living space, use less domestic energy and less industrial and agricultural product per capita, produce smaller quantities of municipal waste, drive and travel less and own fewer cars than their counterparts in most industrialized countries. There is, however, little recognition in these countries of the limits to natural resource use, energy raw materials are used inefficiently in outmoded technologies, waste products of all types are handled and disposed of carelessly, in poor compliance with environmental regulations, and safety rules are not obeyed.

Pollution issues

The population of central and eastern Europe is facing great environmental risks from generally high levels of outdoor and indoor pollution, unhygienic food and poor water quality. The following problems are common to the whole region: acidification of the environment; eutrophication of waters, soil loss from wind and water erosion, reduction in soil fertility due to physical, chemical and biological changes, accumulation of hazardous wastes, loss of habitats and the depletion of genetic reserves.

Vast amounts of industrial and agricultural chemicals and untreated liquid waste have polluted surface and underground waters.

Transboundary rivers, such as the Danube, Elbe and Vistula, transport hazardous materials from one country to another. Waste products are deposited in the Baltic, the Black Sea and the Adriatic Sea, depleting important common resources such as fisheries. Underground drinking water supplies are contaminated in almost every city, town and village. Other areas of concern are the Black, Azov and Caspian Seas, the Volga River and the Kola Peninsula.

There are, in addition, severe and sometimes catastrophic environmental problems associated with specific locations - the 'hot spots'. Each central and eastern European country has such areas which are, typically, densely populated and highly industrialized, with coal-fired power stations, steel making, aluminium and other non-ferrous metallurgy, mining and ore-processing activities. These are all potentially highly polluting.

Several of these economic subsectors are now subject to structural adjustment which could prejudice their very existence.

Health issues

Effects on human health and welfare also need to be considered. Statistics and anecdotal evidence in especially contaminated areas indicate
dramatically elevated incidences of several diseases. A number of health problems can be linked to physical environmental conditions in central and eastern Europe:

- chronic and acute health problems resulting from exposure to lead, other heavy metals and chemicals such as nitrates and arsenic in water,
- threats to normal human development, especially to unborn children and high infant mortality rates,
- respiratory diseases in children and adults, and
- acute health problems caused by environmental disasters.

Unfortunately, the poor quality and inconsistency of data on human exposure to environmental agents make the relationships between pollutant levels and ill health difficult to prove. Human health issues should be given first priority in current environmental activities in central and eastern Europe. Air pollution seems to be the greatest hazard. The intentional and accidental dumping of wastes and consequent incidence of hazardous and toxic pollution have caused widespread soil and groundwater contamination. Contaminated drinking water supplies and agricultural products are thus serious contributors to poor health.

The use of poor quality brown coal is a major health concern. It results in high particulate emissions in the neighbourhood of power plants and also contributes two thirds of the total sulphur dioxide emissions originating from central and eastern European countries. These countries currently export 59-74 per cent of their sulphur dioxide emissions. However, 36-59 per cent of the sulphur dioxide deposited on their territory originates outside their borders. During the 1960s, an even larger amount of imported pollution accumulated in the region, much of it arising from western Europe. This created a long-term legacy of soil and vegetation contamination: sulphur concentrations are reported as being equivalent to five times natural background levels.

Poor air quality in built up areas, with its associated health problems, is substantially influenced by the vehicles of central and eastern Europe being among the world’s dirtiest in terms of emissions. They produce much higher quantities of nitrogen oxides, carbon monoxide and hydrocarbons per kilometre travelled than cars and trucks in the west. There are few catalytic converters installed and most cars used leaded gasoline.

Environmental management
Most western European countries have adopted relatively stringent environmental legislation and advanced regulatory systems and have ambitious, long-term national environmental policy programmes aimed at sustainable development. Central and eastern European countries compare unfavourably in terms of regulatory enforcement, resource management and environmental quality.

Environmentalism played a key role in several central and eastern European countries at the beginning of the transition process. Despite this, popular support for environmentalism is currently much more limited than in western societies. Since the political transition, environmental issues have assumed secondary importance for the major political groupings, whether in power or opposition.

A few countries, such as Poland, have used external financial and technical assistance to develop a consistent scientific and professionally based environmental strategy. However, priorities and resource allocation are commonly inconsistent, and it is questionable whether existing environmental programmes are targeting the most important problems. Reliable data on the state of the environment are rarely available and monitoring systems, where they exist, often cover relatively small areas and provide inadequate information about many important pollutants.

Environmental costs are not internalized in decision making and accounting procedures, and the ‘polluter pays principle’ is not working. Use of economic instruments is embryonic and existing taxes are inadequate to encourage compliance. Central funding is usually insufficient to produce effective action. Some countries are considering the introduction of new environmental charges and taxes and the establishment of national funds to finance environmental programmes.

Judicial regulation and criminal prosecutions are most unusual and compensation systems for those who suffer injury as a result of environmental damage are nonexistent. There are laws and standards, often incorporating the most stringent conditions, but poorly developed administrative structures and low levels of professionalism curb the effectiveness of enforcement.
Pollution in Gdańsk. The river Vistula is one of the most polluted in the world and drains into the Baltic sea near Gdańsk. Pollution is aggravated by waste and effluent from chemical plants, mineral processing and municipal waste.
Badly defined responsibilities and competition between government bodies further constrain the usefulness of resources devoted to environmental control.

There is a substantial need for technical and financial assistance in environmental institution building, in training for professionals and in policy planning and priority setting. Environmental epidemiology, the prevention of irreversible damage to natural resources and the evaluation of the greatest risks to biological resources, are areas which demand priority attention.

The environmental challenge

The environmental challenge facing the central and eastern European region is twofold: the environment has to be improved whilst macro-economic stability is maintained and micro-economic competitiveness is increased. International linkages in terms of trade and foreign investment have also to be strengthened. The young democracies of central and eastern Europe, however, do not have the financial resources, expertise or structural mechanisms necessary to achieve an early integration of economic and environmental policies.

Unless market failures are corrected, new environmental problems will arise. International institutions have an important role in preventing 'ecological colonialism'. Western environmental assistance has a special significance, not only in assisting in the eradication of existing environmental damage caused by past economic policies, but also in helping the countries of central and eastern Europe to avoid or control new ecological hazards. These may result both from domestic business initiatives and from foreign investors seeking high profits by incurring low environment-related costs in the new markets.

**Bank Involvement**

The Bank is directed by its Agreement to promote, in the full range of its activities, environmentally sound and sustainable development. This is the first time that an international financial institution has been given, in its founding charter, a clear and proactive mandate on environmental protection and restoration.

The Bank is pursuing the following priorities:
- assistance to its countries of operations in environmental policy formulation,
- promotion of the use of a variety of economic instruments to attain higher levels of environmental quality,
- encouragement of the development of an environmental goods and services industry in its countries of operations,
- initiation of, and support for, special studies and programmes to address regional and national environmental problems and to promote environmental education,
- implementation of a comprehensive system for environmental screening and review of its investment projects,
- advice to project sponsors on the conduct of environmental analyses,
- inclusion of environmental conditions in agreements with project sponsors,
- implementation and monitoring of specific environmental control and enhancement measures, and
- identification of municipal development initiatives, such as water supply, municipal effluent treatment, solid waste management and land restoration, which will directly improve environmental conditions for the populations of central and eastern European countries.

Environmental problems in the region are frequently transnational and cross-media in nature. They include
Factories and power stations near Katowice, Poland. Some of the many sources of pollution in Upper Silesia, one of Europe's environmental "hot spots"
such issues as central European air pollution, management of the Danube river basin and pollution control in the Baltic Sea drainage basin. Individual countries will find it very difficult to design cost-effective environmental measures to deal with such large-scale problems. A common approach is required by all the affected countries, including in some instances countries of western Europe. Regional and subregional studies, transboundary and sectoral environmental impact assessments and multinational analytical work will be necessary to provide the framework for broad-ranging pollution abatement programmes. The Bank intends to play an active role in such programmes and to use them as an instrument of European environmental integration.

Regional projects

Baltic Sea Environment Programme

The Bank is an active participant in the Helsinki Commission's Task Force preparing a Joint Comprehensive Programme to reverse the degradation of the Baltic Sea from municipal, industrial and agricultural pollution. The Bank has funded pre-feasibility studies in Kaliningrad and regional assessments of air-borne pollution and agricultural runoff. Project preparation activities are under way with a view to financing environmental management projects in pulp and paper industries, toxic waste management and municipal waste water treatment.

Danube River Basin Environmental Programme

The Bank is prominent among the group of international organizations assisting the riparian states of the Danube River to initiate a comprehensive and coordinated three-year action programme that will deal with areas and problems of acute environmental concern, while also putting in place the building blocks for long-term management of the Danube environment. The Bank's programme during this initial period will focus on preparing investment projects to deal with high priority industrial waste management issues, and developing action plans for several tributaries of the Danube where critical environmental problems exist.

Danube Delta Environment Programme

The 591,000 ha Danube Delta has been declared a Biosphere Reserve by the Romanian government and recently just over half of that area was declared a World Heritage site. The Bank has been working with the Danube Delta Biosphere Authority and the World Conservation Union (IUCN) to develop a programme to strengthen the authority, particularly its capacity to plan environmental programmes and manage the Delta environment. The Bank will also investigate investment needs in the economically important and environmentally sensitive areas of fisheries and tourism.

Environmental assessment

The Bank has initiated a project entitled 'Environmental Assessment Legislation and Policy in central and eastern Europe' to review the current status of environmental assessment in each of the Bank's countries of operations. This project will provide essential information to assist the Bank staff in reviewing projects in the Bank's pipeline, and will also help establish a baseline against which technical assistance in environmental assessment and auditing can be provided.

Environmental impact of the Bank's activities

Each Bank project is screened at an early stage by environmental staff to determine the level of environmental information required. Project sponsors provide environmental information
requested, usually in the form of an environmental assessment or environmental audit. This is reviewed by the Bank and any environmental requirements are incorporated into loan or other agreements as covenants. The Bank requires assurances, for the duration of the period, it is supervising the implementation of the loan, that the environmental measures specified in the agreements are being met.

To date, 14 projects have received Board approval. Four of these are telecommunications initiatives and one is funding for a computer systems company. These projects will have broadly neutral direct environmental effects but could prove positive in a wider context, given that improved communications and information technology generally increase efficiency. Two approved projects fall into the category of assistance to financial intermediaries. The Bank has developed specific procedures to ensure that financial intermediaries perform environmental due diligence investigations on each potential transaction in which they are involved and that they require the ultimate borrowers to provide appropriate environmental information.

The seven other approved projects comprise three food-related loans (manufacturing, storage and processing), two manufacturing ventures (heavy electrical equipment and paper packaging), a district heating project, and a loan to a service industry firm for oil-drilling equipment. In each case, either existing facilities or equipment are being upgraded and modernized or new, modern facilities and equipment are being funded. The equipment proposed was reviewed in each case to ensure that adequate environmental controls were incorporated in the specifications.

The Bank required project sponsors to conduct environmental audits in the case of food manufacturing, storage and processing projects, and the two manufacturing ventures. Project sponsors were also asked to provide the Bank with the results of environmental analyses for the food storage and processing projects and the paper packaging plant as these all involved some expansion of activities which could have environmental impacts outside the project area. Using the results of the audits and environmental analyses, the Bank specified environmental conditions which were incorporated, as necessary in loan agreements. The oil-drilling equipment loan involved no land acquisition or transfer; it was concerned with equipment provision and training to a service industry. The equipment employs a method of drilling which is far superior to the previous methods used regionally for oil exploration and meets modern western safety standards. The district heating project incorporated energy conservation measures, improved controls on heating networks, and replaced inefficient and polluting boilers with much cleaner gas-fired combustion.
Albania

Country review

Key facts

Area
(square kilometres) 28,750

Population
in millions (1989) 3

Sectoral shares in
total employment (1989)
Agriculture 49%
Industry 22%

Infant mortality
per 1,000 live births (1988) 39

Life expectancy
in years (1989) 73

Television sets
per 1,000 inhabitants 83

Workforce with
secondary/higher education 26%

Estimated GDP per capita
(1990), in US$ 1,000*

*See 'measurement problems' on page 33

Sources: Government of Albania, PlanEcon

Political

The regime of Enver Hoxha lasted some 40 years, from 1944 until his death in 1985. It was characterized by purges, terror and by ruptures with one another of Albania's allies. Albania's isolation and lack of economic relations with most of the world since the end of the Second World War resulted in great privation and economic stagnation from which recovery will be extremely difficult.

Hoxha was replaced by his chosen successor, Ramiz Alia, who continued to be President during 1991. As in the early stages of reform in other countries of central and eastern Europe, Albania's government has come under increasing pressure from democratic forces urging rapid and sweeping political and economic liberalization.

Pro-democracy demonstrations throughout 1990 culminating in violence, resulted in President Alia allowing the formation of opposition parties to contest multiparty elections. The Communist Party, renamed the Albanian Socialist Party, won these elections in March 1991 with almost two-thirds of the vote. The Democratic Party (DP), the principal opposition led by Salih Berisha, achieved significant success in urban areas, but was badly beaten by the Communists in rural areas, where most of the population lives, and where news about reform had hardly penetrated. The DP refused an invitation to join the government formed by the Socialist economist Fatos Nano.

The Nano government collapsed in June 1991 after a four-week general strike led by the democratic opposition seeking more rapid political and economic reforms. It was replaced by an interim coalition 'government of national stability', headed by Socialist Ylli Bufi and including seven opposition ministers. This government resigned on 10 December 1991, as a direct result of opposition pressure. On 14 December, President Alia appointed a new caretaker government of technocrats headed by former Food Minister Vilson Ahmeti, pending new elections.

Albania is now internationally understood to have embarked on the process of transition to multiparty democracy, pluralism and market-oriented economic reform. It is a member of the CSCE and has special guest status at the Council of Europe.

Economic

Albania's economic conditions had been deteriorating significantly since 1989, and in 1991, the country was in a state of severe crisis. In the first half of 1991, output fell year-on-year by 30 per cent. There was a severe shortage of food, medicine and heating fuels. Foreign debt accumulated to $400 million, representing almost five times the earnings from exports of goods and services.

The economic decline since 1989 was exacerbated by special factors, such as a severe drought in 1990, strikes and power failures. Disruptions associated with the spontaneous dismantling of the cooperative sector also contributed, as did the partial collapse of the distribution system and reduced access to basic inputs from CMEA countries. The main underlying cause of the deterioration, however, is an accumulated...
misallocation of resources - the result of four decades of extreme central planning, radical egalitarianism and, since 1978, an uncompromising policy of self-reliance.

The Government has pursued economic reform since April 1991, when private ownership was legalized for all types of property, except land, and a credit programme for new private economic institutions was introduced. To stimulate agricultural production, some farm output was liberalized and the size and number of private plots were expanded. Reform measures, including a sharp currency devaluation and liberalization of some prices, were ratified by parliament in October. Privatization under the auspices of a newly created National Privatization Agency is in the initial stage of preparation.

Environmental

Albania suffers both from natural resource depletion and from significant levels of industrial pollution as a result of past policies. Environmental legislation, where it exists, is not generally enforced and monitoring and analytical capabilities are feeble. Consequently, Albania cannot, at present, incorporate a realistic evaluation of 'external' environmental costs in its investment decisions nor can it translate the findings from monitoring and other investigations into effective action.

There is no ministry with environmental responsibilities, although a Committee for the Environment reports to the Council of Ministers. The Ministry of Health has responsibility for environmental monitoring. Particular areas of concern are the levels of in-plant and external industrial pollution, which affect relatively large numbers of the population, and the loss of tree cover near to urban centres due to the use of wood as a domestic fuel.
Albania Bank Involvement

Strategy

On 16 December 1991, the Board of Directors agreed an initial strategy for Albania. It focused on five priority areas; banking sector, privatization, energy, environment and telecommunications.

The banking sector, an obvious cornerstone in the transition of the economy, was identified as a priority area, requiring substantial and immediate technical assistance. Under the previous regime, banks did not have authority to make independent credit decisions, loan portfolios were not classified by risk categories and provisions against loan losses were not made. The European Bank will focus its initial assistance on training and institutional building through technical assistance, especially with regard to:

- rapid establishment of accounting standards and procedures by commercial banks,
- creation of an efficient national payment clearing centre,
- development of management logistics, business planning and information systems within the Albanian Commercial Bank, and
- enhancement of retail banking, treasury management, foreign exchange dealing, risk management, appraisal and credit analysis skills.

The privatization process needs comprehensive support. The Bank intends to provide technical assistance to strengthen the National Privatization Agency so as to assist the small asset and medium size enterprise privatization programmes. The Bank will help select qualified advisors and guide their work, coordinating its efforts with those of other multilateral institutions.

The Bank will assist in the drafting of laws and in the training of lawyers especially in the banking sector and the privatization process.

Energy and the environment are both key areas for attention. Bank activities will include assessment of lignite mining and processing project aimed at reducing deforestation. It will also commission a study on forest cover and a study on the modernization of the petroleum sector in an environmentally sound and sustainable way.

The Bank is also commissioning a study to recommend an appropriate strategy for the development of tourism.

The existing telecommunications network, with probably one of the lowest telephone densities in the world, is clearly inadequate for private sector development. The government has asked the Bank to prepare a comprehensive telecommunications development plan and to provide advice on the encouragement and selection of further private sector investments.

Through an initial programme of technical assistance, the Bank intends to assist in the creation of the infrastructure for future investment projects in areas such as commercial banking, private sector development and the oil and tourism industries.

Technical Assistance

Technical Assistance was extended to Albania in the form of training for two senior bankers (ECU 11,600 was committed.)
Bulgaria

Country review

Key facts

Area (square kilometres) **110,910**
Population in millions (1993) **9**
Sectoreal shares in total employment (1989)
- Agriculture **18.6%**
- Industry **45.9%**
- Services **35.5%**
Cars per 1,000 inhabitants (1987) **127**
Telephones per 1,000 inhabitants (1991) **250**
Infant mortality per 1,000 live births (1991) **16.5**
Life expectancy in years (1991) **71**
Eligible male labour force participation (1980s) **81%**
Eligible female labour force participation (1980s) **74%**
Workforce with secondary/higher education **29%**
Estimated GDP per capita (1990), in US$ **5,500**

* See measurement problems on page 33
Sources: OECD Secretariat
UN Economic Commission for Europe
European Bank estimates
National authorities
PlanECO

Political

The dismantling of the old single political party system, rapid democratization and the transition to a market economy coincided with an increasing power struggle in 1991 between the two major political parties in Bulgaria - the Bulgarian Socialist Party (BSP) and the Union of Democratic Forces (UDF), of which President Zhelev was a founding member. The former was committed to 'democratic socialism'. The latter advocated a more market oriented system. There were more than 80 other political parties and movements in 1991, all firmly anti-communist.

The adoption of a new constitution and the elections dominated internal politics throughout 1991. In July, Bulgaria adopted a new constitution which laid the foundations for a genuinely democratic society and market economy. Parliamentary multi-party elections then took place on 13 October 1991, against a background of rising social tensions, aggravated by the declining state of the economy and by unemployment.

The Movement for Rights and Freedom, representing the Turkish ethnic minority, not previously considered as a party, emerged as the third force with 7.55 per cent. The first non-communist government in Bulgaria since the end of the second World War was formed by the UDF, under Prime Minister Filip Dimitrov. The UDF won 34.36 per cent of the votes against the BSP's 33.14 per cent.

Local governments, elected by popular vote for a three-year term, started the process of decentralization. Complete freedom of the press was introduced. Despite economic constraints, the media became an increasing influence on the internal political scene.

In foreign policy, Bulgaria supported political initiatives to expand regional economic cooperation and aiming to advance Bulgaria's commitment to European democratic values. Bulgaria plans to become a member of the Council of Europe in 1992 and to integrate itself into Europe's political and economic structures.

Economic

During 1991, in the face of severe structural problems and a recession which has reduced real GDP by more than a quarter, the Bulgarian authorities have mounted an impressive effort to redress the external macroeconomic imbalance and reduce inflationary pressures.

The government's tight financial policies accompanied a comprehensive liberalization of prices and imports. At the same time, private ownership was legalized and the need for privatization of state enterprises was recognized.

The government removed price controls from most products, phased out subsidies and increased remaining controlled prices significantly. Retail prices rose by more than 200 per cent in February 1991 and another 150 per cent in March. However, monthly inflation had fallen back to 3-5 per cent by November. The real value of the wage bill dropped by over 60 per cent during 1991. The fall effect of the recession was not fully reflected in registered unemployment in spite of the fact that it increased tenfold, affecting 11 per cent of the labour force.

A unified floating exchange rate system was introduced in February 1991. The exchange rate is now determined in the interbank market and the central bank fixes the interbank rate daily on the basis of the previous day's actual transactions. During 1991, the domestic currency was devalued by over 300 per cent.
In the first half of 1991, the convertible currency export value (excluding transactions under the clearing arrangement with the former USSR) declined by 26 per cent (measured in US dollars), while the import value dropped by 61 per cent. Trade with the former USSR also fell drastically. By September 1991, Bulgaria's external convertible currency reserves amounted to US$ 200 million, equivalent to less than one month's imports. Bulgaria's total external debt, at around US$ 12 billion, tripled since 1985. Almost half of the debt is short-term.

In March 1990, the Foreign Trade Bank, which carries 95 per cent of the commercial debt on its books, responded to a liquidity crunch by announcing a unilateral debt-servicing moratorium. It also requested the opening of debt restructuring negotiations. In April 1991, agreement was reached with the Paris Club to reschedule the official debt due until mid-1992 over ten years, with a six years grace period. Negotiations are still continuing on the 85 per cent of the external debt owed to commercial banks.

**Selected economic indicators for Bulgaria**

*General government. Includes on the expenditure side, due but unpaid interest obligations.
**End-year, convertible currencies only — denotes not available.
Sources: Data provided by national authorities and European Bank estimates.

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<tbody>
<tr>
<td>GDP at constant prices (% change)</td>
<td>2.4</td>
<td>-0.3</td>
<td>-1.8</td>
<td>-26.0</td>
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<tr>
<td>Unemployment as % of labour force</td>
<td>-</td>
<td>0</td>
<td>2.0</td>
<td>10.0</td>
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<tr>
<td>Consolidated budget balance (% of GDP)*</td>
<td>-5.6</td>
<td>-1.4</td>
<td>-13.7</td>
<td>-14.0</td>
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<tr>
<td>Consumer prices (% change)</td>
<td>3.0</td>
<td>6.0</td>
<td>20.0</td>
<td>470.0</td>
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<td>Units domestic currency per US$ (end-year)</td>
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<td>22.0</td>
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<td>External current account (US$ million)</td>
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<td>-1307.0</td>
<td>-1152.0</td>
<td>-2027.0</td>
</tr>
<tr>
<td>Gross external debt (% of exports of goods and services)**</td>
<td>156.6</td>
<td>227.4</td>
<td>286.8</td>
<td>201.3</td>
</tr>
</tbody>
</table>

**Environmental**

The energy and resource-intensive nature of Bulgaria's economy, combined with outdated control and industrial processes, resulted in very high levels of air and river pollution, particularly from industry. Heavy metals and other toxic substances contaminate the soil and water and have left a legacy of potentially hazardous wastes.

Over one million of Bulgaria's nine million inhabitants live in 'hot spots', where over-exposure to lead and airborne particulate problems are common. Furthermore, high concentrations of arsenic occur in a number of places as a by-product of ferrous and non-ferrous metal industries.

The need for new legislation has been recognized and generic environmental laws were drafted in 1991. In addition, however, more specific legislation on water, waste and air pollution is required, together with institutional strengthening, particularly at the local level.
The Bank's priorities for its operations in Bulgaria include potential infrastructure projects, especially in transport, telecommunications and energy, and investment in agriculture. It will also consider investments to improve management practices in energy end-user sectors, especially in industry.
**Strategy**

On 25 November 1991, the Board of Directors agreed on an initial strategy for Bulgaria. It focuses on four main activities:

- privatization and restructuring of state-owned enterprises and banks, and support for selected private enterprises in priority sectors,
- modernization of the financial sector, including the promotion of specialized institutions such as leasing firms and export credit agencies,
- infrastructure projects, especially transport, telecommunications and energy, and
- investment in agriculture.

**Privatization and restructuring**

In cooperation with other international financial institutions, the Bank will continue to provide support for the development of overall privatization policies and for the creation of a detailed database focused on the potential for privatization of state enterprises. The Bank may also provide technical assistance to cover the training, materials and equipment requirements of the Privatization Agency. The Bank is ready to provide help in monitoring the performance of state-owned enterprises and to assist with the implementation of commercial practices and the improvement of management techniques within individual state enterprises. Pending passage of the privatization bill, the Bank will also examine its potential role in specific privatizations. This could include the provision of advice on feasibility, design, underwriting and marketing, and equity participation in privatized enterprises.

**Modernization of the financial sector**

The Bank’s objective is to enhance the commercial orientation of banking services and to support the growth of a competitive environment. The Bank may contribute to an expansion of profitable productive entities by extending credit lines to selected intermediary banks and financial institutions for on-lending to viable enterprises. In addition, the Bank may opt for equity participation to strengthen the capital base of certain intermediaries, thereby gaining direct influence on the restructuring process.

**Infrastructure projects**

The Bank may participate in projects aimed at improving road quality and coverage. These could include the completion of 140 km of the Trans-European Motorway and the continued construction of highways from Sofia to the Black Sea ports of Varna and Bourgas.

Although the Bulgarian Railways Company is expected to remain wholly state-owned, an anticipated reduction of subsidies will force the company to compete with road transport. The Bank could provide technical assistance to support this process as well as contributing financially to plans to update and expand the main rail links from Yugoslavia to Turkey and from Sofia to Varna and Bourgas.

The Bank could play a useful role in preparations for the establishment of market-based telecommunications operations. Bank financing and technical assistance could support the design of a new organization and the development of its management and staff.

Other areas which might merit the financial or technical participation of the Bank include investments in the
hydrocarbon, power and district heating sub-sectors, improvement of management practices in energy end-user sectors, especially in industry, and development of gas pipelines and connection of the electricity grid to the regional network.

Investment in agriculture

The Bank sees potential for increasing agriculture output rapidly by expanding private land ownership under the provisions of the Land Law of July 1991. It will consider providing credit lines for private farms, loans for specific investment such as storage facilities and transportation equipment and technical assistance in the decentralization/privatization process.

Technical assistance

The Bank assisted the Ministry of Industry, Trade and Services (MITIS) in the launch of the Bulgarian Privatization Programme. The Bank drew up a funding proposal covering the country's needs for technical assistance in restructuring and privatization. This proposal formed part of the submission which secured a PHARE allocation for the programme, in which the World Bank is also involved.

Resident office

It is anticipated that a resident office in Sofia will be operational by April 1992.
CSFR

Country review

Key facts

Area (square kilometres): 127,870
Population in millions (1989): 18
Sectoral shares in total employment (1989): Agriculture 12%, Industry 46%
Cars per 1,000 inhabitants (1987): 122
Telephones per 1,000 inhabitants (1987): 246
Infant mortality per 1,000 live births (1988): 12
Life expectancy in years (1989): 71
Eligible male labour force participation (1989): 82%
Eligible female labour force participation (1989): 77%
Workforce with secondary/higher education: 29%
Estimated GDP per capita (1990), in US$: 8,000*

*See 'measurement problems' on page 33
Sources: Government of CSFR, PlanEcon

Political

1989's "Velvet Revolution" peacefully ended the post-war era of Communist domination of Czechoslovakia, an era brutally interrupted by the Prague Spring of 1968. Since 1989, the country made important political reforms, establishing a state based on law and working toward a new relationship between the Czech and Slovak Republics. Opposition leader Vaclav Havel was elected President of Czechoslovakia by the Federal Assembly on 29 December 1989.

The same month, Marian Calif was appointed Prime Minister.

In 1991, a Charter of Fundamental Rights and Freedoms was adopted by the federal government. It guaranteed freedom of speech, religion and the media and equality under the law.

Both Civic Forum and Public Against Violence, which led the 'Velvet Revolution,' split into various new parties beginning in early 1991. By the end of the year, the Federal Assembly had members from 15 parties, spawned from the six which won seats in 1990. Parliamentary debate on new federal and republic constitutions proved contentious throughout 1991 with no accord on a clear delineation of federal and republic powers. Cooperation with the rest of Europe was central to CSFR foreign policy in 1991. The CSFR became a member of the Council of Europe, signed the European Convention on Human Rights and Fundamental Freedoms and an Association Agreement with the European Community. The CSFR joined Hungary and Poland in the Declaration of Vistagrad, which committed the three countries to closer cooperation in democratic and market economic reform. The CSFR is also a member of the Hexagonale, a regional group which also includes Austria, Italy, Poland, Hungary and Yugoslavia.

Economic

The CSFR emerged from the initial phase of economic transition with considerable macroeconomic success. Thanks to restrictive fiscal and monetary policies, the CSFR achieved significant liberalization of prices and internal convertibility of the currency while controlling inflation and maintaining a solid balance of payments position. The price level jumped immediately after the liberalization of prices in January 1991, but the monthly inflation rate decelerated sharply and prices stabilized by mid-year.

Price liberalization in January 1991, together with follow-up measures, reduced the share of goods with regulated prices from 85 per cent to about 5 per cent. The external current account in convertible currency had a small surplus in 1991. Wage settlements were restrained, with average nominal wages rising by slightly over 20 per cent during 1991, i.e. a real wage reduction of over 30 per cent.

However, output declined severely and unemployment rose sharply in 1991 through a combination of the collapse of exports to former CMEA countries, decline in domestic demand and supply side factors. Real GDP is estimated to have declined by about 16 per cent in 1991, and unemployment, which had virtually been unknown, rose to 6.6 per cent by the end of the year. Exports also declined by over 15 per cent, with those to the former USSR being halved.

Unification of the exchange rate and liberalization of imports began to exert competitive pressure on an economy which is still characterized by production monopolies. However, restructuring of state enterprises is proving to be difficult and is
protracted. Although privatization of small business units is progressing smoothly, privatization of most large enterprises will start in 1992 despite the adoption of a fast-track, mass-privatization approach. In the financial system, the quality of banking services remains low, and the problem of asset quality and capital adequacy of commercial banks spun off from the state monobank remains a problem, although measures have been taken to address these issues.

Environmental

Environmental degradation in all forms - land, air and water - has been severe in the CSFR and large areas of the country are polluted.

Atmospheric pollution is especially severe in industrial areas with high population densities including Prague, the northern Bohemia region, Bratislava, the Ostrava-Karviná industrial complex and the Váh River valley. Sulphur emissions are the second highest in Europe and are mainly produced by power and heating plants using low-quality brown coal, lignite or heavy fuel oil. Coal deposits lie close to the surface and this has resulted in very extensive open-pit mining operations creating a ‘lunar landscape’ in parts of the country.

More than 50 per cent of agricultural land is seriously affected by erosion, with in excess of 5 million tons of soil a year estimated as being washed away. Deforestation, acidification, contamination and siltation of water flows and reservoirs now affect about 80 per cent of the agricultural land area.

Although forests cover more than a third of the CSFR, over 60 per cent of the existing forest cover has been damaged by emissions and deposits.

<table>
<thead>
<tr>
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<th>1988</th>
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<tr>
<td>GDP at constant prices (% change)</td>
<td>2.9</td>
<td>1.3</td>
<td>3.2</td>
<td>-0.6</td>
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<tr>
<td>Unemployment as % of labour force</td>
<td>-</td>
<td>0</td>
<td>2.6</td>
<td>7.0</td>
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<tr>
<td>Consolidated budget balance (% of GDP)</td>
<td>-3.6</td>
<td>-3.5</td>
<td>2.0</td>
<td>1.2</td>
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<tr>
<td>Consumer prices (% change)</td>
<td>0.2</td>
<td>1.4</td>
<td>10.0</td>
<td>58.0</td>
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<td>Units domestic currency per US$ (end-year)</td>
<td>14.0</td>
<td>14.0</td>
<td>28.0</td>
<td>28.0</td>
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<td>External current account (% of GDP) *</td>
<td>-0.1</td>
<td>0.9</td>
<td>2.4</td>
<td>3.4</td>
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<tr>
<td>Gross external debt ** (% of exports of goods and services)</td>
<td>114.1</td>
<td>114.7</td>
<td>107.2</td>
<td>-</td>
</tr>
</tbody>
</table>

Selected economic indicators for CSFR

* in convertible currencies ** End-year, convertible currencies only – denotes not available

Sources: Data provided by national authorities and European Bank estimates.
CSFR Bank Involvement

Strategy

On 29 July 1991, the Board of Directors approved the Bank's initial strategy in the Czech and Slovak Federal Republic (CSFR).

Priority sectors and activities wherein the Bank is screening projects of potential interest include the following:

Privatization, restructuring and promotion of the private sector

The Bank will become directly involved in the privatization of small, medium and large-scale companies, the promotion and establishment of new private enterprises and the support of joint ventures between domestic firms and foreign partners. For the time being, the Bank's approach to privatization and to the promotion of private sector growth will not be targeted on any specific area. The Bank will examine all requests for support on their merit, consonant with sound commercial practices. However, priority is being assigned to those activities which will create employment and provide opportunities for enhanced exports and foreign exchange earning. Preference is also being given to the participation of foreign private investors with the ability to provide badly needed managerial and technological know-how and access to foreign markets.

Development of the financial sector

One of the key areas for Bank support to the CSFR is the banking and financial sector. To satisfy both the market demand for medium and long-term capital, and to help remedy deficiencies in the system, credit lines might be extended to selected intermediary banks and financial institutions for on-lending to viable enterprises. Once proper assessment of the institutional capabilities of selected intermediaries has been made, Bank equity participation may be needed to strengthen their capital bases. In preparing the way for privatization, there is scope for Bank support in upgrading the appraisal capabilities of intermediaries through training and technical advisory activities, as well as in helping to establish new term lending institutions.

The Bank may also play a catalytic role in promoting the establishment of specialized financial institutions. In particular, the Bank could assist the creation of export financing and guarantee arrangements which are needed to support CSFR exports.

Infrastructure

In view of the complexity and the scale of the needs in the various infrastructure sectors, coordination and co-financing with other international organizations will be key features of the Bank's approach.

Telecommunications Success in revitalizing and privatizing all sectors of the economy will depend to a significant extent on the modernization and capacity extension of the CSFR telecommunications sector. Bank support will be channelled to help facilitate the implementation of the government's development programmes. These projects involve the construction of a digital overlay network which includes transit and local exchanges as well as east-west and north-south optical fibre routes.

Transport The government is planning a fundamental reorientation of the policies and approach to the transport sector. These changes provide good
opportunities for Bank support. Plans to introduce competition and to privatize transport services also offer opportunities for the Bank to fulfill its mandate, while financial input from the Bank could expedite the process of upgrading and modernizing the railway network and the rolling stock. Within the air transport sector, the Bank recognizes the high priority conferred on the expansion and modernization of the airports in Prague and Bratislava, to meet international standards.

**Energy** Since the preponderance of polluting agents in the CSFR can be traced to its current, mainly coal-based energy sources and processes, the Bank could play a major role in helping to alleviate environmental damage in the CSFR by targeting investments and lending to the energy sector. These might take the form of projects for desulphurization, water treatment and regional gas and heating networks. The Bank will explore the possibility of co-financing energy sector projects with the World Bank which has initiated a programme of studies in this field.

**Environment** Improvements to the country's environment serve as one of the unifying elements of the Bank's programmes in the CSFR. The Bank's environmental programme for the CSFR will have, initially, three main themes:
- the provision of expert advisory services,
- the provision of financing for basic municipal water treatment plants, and
- energy conservation in the form of combined heat and power production and district heating schemes in the large urban centres.

In addition to energy conservation and efficiency benefits which are vitally important for a country with so few energy resources, the above approach would achieve a significant reduction in sulphur and other emissions. The Bank will supplement such activities with advice on a more realistic energy pricing system to enhance the energy conservation effort.

**Municipal development** The upgrading and extension of currently run-down public utilities will be essential for the efficient functioning of urban centres and it is clear that external support will be required in every area. The design and implementation of water supply, sewage, solid waste disposal, telecommunications and power transmission projects will be required to correct present major deficiencies. Urban transportation requires particular attention.

**Other sectors** The Bank will consider the desirability of assisting private sector development of tourism in both the Czech and Slovak Republics since the hotel and tourism sector could become an important source of employment and hard currency earnings within a relatively short period. The European Bank will explore, in conjunction with other organizations involved in the CSFR education sector, how it can best contribute to meeting the needs identified in this sector.

**Bank operations**

Czechoslovakia Investment Corporation Inc
On 24 September 1991, the Board of Directors approved the creation of the Czechoslovakia Investment Corporation Inc. The European Bank will be one of its major shareholders, with an equity investment of US$10 million (ECU 7.46 million), and an active Board
member. The investment corporation is being created by Robert Fleming, a major British investment manager and Investicni Banka, one of the largest CSFR banks. Through its involvement in the fund, the Bank will be fulfilling its mandate to assist small and medium-size enterprises and to attract capital to central and eastern Europe.

Čokoládovny
In December 1991, the Board also approved an equity investment equivalent to US$ 30 million (ECU 24.10 million), equivalent to a 15 per cent stake, in the food company Čokoládovny. The project involves the restructuring and privatization of the CSFR's major producer of chocolates and biscuits and is being undertaken in conjunction with two large western European food groups, Nestlé and BSN.

The CSFR will also be one of the countries of operations of the NMB/EBRD Central Europe Agency Line (see operations under Poland for further details).

Technical assistance
The Bank undertook one technical assistance project in the CSFR in 1991. Under the Czechoslovak Telecommunications project, the Bank intends to provide technical assistance to Czech and Slovak SPTs for the creation and management of an Institutional Development Programme (ECU 570,000 was committed). The CSFR will also be one of the countries to benefit from the Regional Training Programme for Financial Markets Development once it is set up.
Hungary
Country review

Key facts

Area (square kilometres) 93,030
Population in millions (1991) 10.4
Sectoral shares in total employment (1990) Agriculture 24%, Industry 31%
Cars per 1,000 inhabitants (1990) 194
Telephones per 1,000 inhabitants (1987) 152
Infant mortality per 1,000 live births (1988) 16
Life expectancy in years (1989) 70
Eligible male labour force participation (1980a) 78%
Eligible female labour force participation (1980a) 62%
Workforce with secondary/higher education 34%
Estimated GDP per capita (1990), in US$ 6,000*

Politic

Some 50 parties participated in democratic parliamentary elections in March - April 1990, which resulted in a governing coalition led by the centre-right Hungarian Democratic Forum (HDF), under Prime Minister Jozef Antall. The second largest party, the Alliance of Free Democrats (AFD) formed the opposition. The Hungarian Socialist Workers Party (comprising the more conservative wing of the former communist party), did not receive the minimum votes necessary to win seats.

The previous government, under the premiership of Miklós Németh, now a Vice President at the European Bank, prepared the ground for these events. The Hungarian Constitution was substantially revised in October 1989, creating the legal conditions necessary for free, multiparty elections and separating the legislative, executive and judicial functions. Key legislation was passed, including laws covering referenda and guaranteeing freedom of the press.

In 1991, Hungary progressed steadily along the path of democratic and economic reform. Devolution of power from the centre continued. A law on public finances, redefining the division of revenues between central and local government was put before parliament. The Constitutional Court strengthened its institutional position during 1991, its role being to define presidential powers relative to those of parliament and to review laws under consideration and passed by the parliament. Numerous trade unions and other associations flourished. However, both coalition and opposition parties faced difficulties in sustaining active popular support.

In foreign policy, Hungary strengthened its regional relationships, through the Visegrad declaration on mutual cooperation with the CSFR, Hungary and Poland and through the regional political and economic group, the Hexagonale. Hungary signed an Association Agreement with the EC in December 1991. Closer ties are also being pursued with EFTA. Together with other central and eastern European countries, especially the CSFR and Poland, Hungary is trying to establish links with NATO and with the Western European Union.

Economic

The Hungarian economy made considerable progress in 1991. The current account side of the balance of payments was in surplus for the second year running. New, small enterprises were formed at an impressive pace. Prices, interest rates and imports were almost completely liberalized. The level of direct foreign investment rose sharply, providing the basis for a much-needed accumulation of foreign exchange reserves. However, production continued to decline and inflation accelerated.

Real GDP declined by four per cent in 1990 and a further eight per cent in 1991, mainly as a result of the CMEA collapse, the phased reduction of subsidies and increased competition from the West. Registered unemployment rose from 1.7 per cent of the labour force at the end of 1990 to more than eight per cent in December 1991. In spite of the fall in real wages for the second consecutive year. While the overall state of the economy remained depressed, small-scale enterprises performed well.

Output from industrial entities with less than 50 employees rose by 50 per cent in the first half of 1991.

Inflation rose from 17 per cent in 1989 to 35 per cent in 1991. The surprisingly severe output contraction, relative to credit growth, may have
contributed to this development, but a variety of cost-push factors also played a role, in particular a cut in price subsidies.

Hungary’s convertible reserves quadrupled to more than US$ 4 billion over the 13 months to December 1991, helped by increased foreign currency deposits of Hungarian nationals and a successful flotation of state-guaranteed bonds in international capital markets, reflecting strengthened confidence in the economy. This rise was also boosted by a sharp increase in direct foreign investment and a surplus in the current account. Although the need for international reserves also rose (because convertible imports increased rapidly), the reserves position was more comfortable than at any time since 1986. Convertible currency debt stood at US$ 19.7 billion by mid-1991 (63 per cent of GDP).

The government moved ahead with its structural reform programme, although the pace of privatization was somewhat slower than originally intended. The programme aims to cut the state’s share of assets in the competitive sector to less than 50 per cent by the end of 1993, and to reduce legal and administrative market interference. A high degree of price and import liberalization will stimulate effective competition in the private sector.

Environmental

Natural resources and the man-made environment are under severe threat in Hungary. Air quality is less than satisfactory in 11 per cent of Hungary, where 44 per cent of the population lives. The worst areas are industrial agglomerations, notably Budapest, Nograd and the Budapest, Komarom and Veszvar industrial zones, and the largest cities where traffic is heavy and results in excessive lead emissions.

About 65 per cent of potable greenfield reserves do not have sufficient natural protection against surface pollutants. In Budapest, only 20 per cent of sewage effluent is treated biologically; the remaining 80 per cent, 630,000 cubic metres a day, ends up untreated in the Danube.

Communal water supplies in Hungary are becoming increasingly polluted, mostly with untreated sewage: some 1.5 billion cubic metres per year is discharged into surface waters.

Solid waste problems are in need of special attention. The sites of previous illegal dumps and their environmental effects are unknown. Long-term storage of low and medium level radioactive wastes also presents a significant problem. Over half of the municipal waste tips do not comply with regulations and there is a critical shortage of well-regulated tips.

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>GDP at constant prices (% change)</td>
<td>-0.2</td>
<td>-0.2</td>
<td>4.3</td>
</tr>
<tr>
<td>Unemployment in % of labour force</td>
<td>5.3</td>
<td>2.0</td>
<td>8.0</td>
</tr>
<tr>
<td>Consolidated budget balance (% of GDP)**</td>
<td>0.9</td>
<td>0.8</td>
<td>-0.1</td>
</tr>
<tr>
<td>Consumer prices (% change)</td>
<td>16.1</td>
<td>17.6</td>
<td>28.5</td>
</tr>
<tr>
<td>Units domestic currency per US$ (end-year)</td>
<td>5.8</td>
<td>6.0</td>
<td>6.0</td>
</tr>
<tr>
<td>External current account (% of GDP)</td>
<td>2.9</td>
<td>4.5</td>
<td>0.4</td>
</tr>
<tr>
<td>Gross external debt (% of imports of goods and services)**</td>
<td>335.1</td>
<td>278.9</td>
<td>247.8</td>
</tr>
</tbody>
</table>

Selected economic indicators for Hungary

*GFS basis, including central and local budgets. **End-year, convertible currencies only.

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Sources: Data provided by national authorities and European Bank estimates

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Number of parliamentary seats

Results of elections in March/April 1990

1. Democratic Forum 122
2. Fidesz Democratic 92
3. Independent Socialists 43
4. Socialists 33
5. Young Democrats 21
6. Christian Democrats 21
7. Others 21

---

31 European Bank for Reconstruction and Development
<table>
<thead>
<tr>
<th>Funding</th>
<th>ECU million</th>
</tr>
</thead>
<tbody>
<tr>
<td>European Bank lending</td>
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<tr>
<td>Anticipated syndicated lending</td>
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</tr>
<tr>
<td>European Bank committed</td>
<td>4.91</td>
</tr>
<tr>
<td>Other lenders</td>
<td>0</td>
</tr>
<tr>
<td><strong>Total lending</strong></td>
<td><strong>4.91</strong></td>
</tr>
<tr>
<td>Other equity investment</td>
<td>1.18</td>
</tr>
<tr>
<td>To be sourced</td>
<td>5.65</td>
</tr>
<tr>
<td><strong>Total project investment</strong></td>
<td><strong>11.74</strong></td>
</tr>
</tbody>
</table>

Scanning, printing and finishing operations at Petőfi Nyomda Rt., a packaging material manufacturing company in Hungary.

The Bank made its first private sector loan to this company.
Strategy

The Bank's strategy for Hungary, as approved by the Board on 24 June 1991, will focus initially on those areas where the ground for Bank involvement has been sufficiently prepared, and will address the European and regional dimensions, infrastructure and environmental concerns. The main elements of the Bank's initial strategy will be geared toward the following:

- privatization, promotion of the private sector and restructuring of state-owned enterprises, aimed at strengthening the competitive sector of the economy,
- strengthening and creation of financial services and institutions, particularly those with activities oriented toward small and medium-sized enterprises,
- strengthening of infrastructure, with particular concern for the needs of the private sector and by making use of private entrepreneurship in infrastructure development,
- environmental rehabilitation, and
- municipal services and development programmes.

Attention will be concentrated on investment programmes of regional significance and on projects that would benefit enterprises both from Hungary and the Bank's other countries of operations. The Bank will consistently emphasize the catalytic nature of its operations. Its strategic approach and choice of projects, for example, are expected to help create a market for external capital flows to profitable businesses in Hungary.

Privatization

A top priority of the Bank is to help strengthen the competitive sector of the economy. Specifically, the Bank will emphasize investments which will make Hungarian companies more competitive in world markets. Various types of transactions, including restructuring/privatization of state enterprises, modernization/capacity expansion of private companies and green-field joint ventures, will be considered.

The Bank's privatization and restructuring work will cover the full spectrum of state assets, including public utilities and banks. The Bank will address these tasks by creating or participating in institutions to leverage the Bank's assistance (such as equity funds) and through direct advice to, and debt and equity investment in, enterprises themselves. The Bank will coordinate its activities with those of other institutions involved in the area.

The Bank's investment selection strategy will support sound, market-driven initiatives and will assist the private sector in its efforts to identify and utilize market opportunities. In addition to financial viability, a number of other important selection criteria, notably, the generation of export earnings, acquisition of business know-how, employment creation and the development of entrepreneurial skills, are considered.

Financial sector

An important strategic objective is to develop the financial services industry and capital markets to match the demands of a market-driven economy. Particular emphasis being placed on the needs of small and medium-sized enterprises. The Bank will examine vehicles such as credit lines to local intermediaries committed to providing long-term financing to local clients. Bank support for the creation of new financial institutions is also envisaged.
<table>
<thead>
<tr>
<th>Funding</th>
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<tbody>
<tr>
<td>European Bank lending</td>
<td>90.68</td>
</tr>
<tr>
<td>Anticipated syndicated lending</td>
<td>0</td>
</tr>
<tr>
<td>European Bank committed†</td>
<td>90.88</td>
</tr>
<tr>
<td>Local funds</td>
<td>96.22</td>
</tr>
<tr>
<td>Total project investment</td>
<td>187.10</td>
</tr>
</tbody>
</table>

The Bank is financing Hungary Telecommunications' ongoing modernization and expansion programme. Old systems, still being used, will be phased out.
Infrastructure
Telecommunication and transportation infrastructures are in urgent need of upgrading and expansion. The Bank will seek to support and expedite the implementation of current investment programmes in cooperation with other multilateral institutions, such as the World Bank and the European Investment Bank. Private sector participation through Build, Operate and Transfer (BOT) schemes, or other similar mechanisms, will also be encouraged.

Energy and environment
Current energy policies envisage structural change and diversification of energy resources. Bank support in various forms will be considered to help the government secure energy supply, to promote energy conservation and energy-generating efficiency and to help create entities suitable for privatization. The planned integration of the power and gas grids with those of western Europe and the private sector involvement being contemplated in power generation, in particular, could offer interesting opportunities for the Bank.

Environmental considerations are an essential component of all Bank operations. In the short term, the Bank will aim to stem the deterioration of the environment by addressing environmental concerns on a case-by-case basis. The longer term objective is to restore and improve environmental conditions (through private sector related environmental investments and other means) to provide sustainable economic development.

Municipal services
Local governments are playing an increasingly important role in the transition to a market economy. As assets are transferred from central government to local administrations and a growing proportion of resources are managed at the local level, the role of local government in providing and implementing a framework for privatization is expanding. Municipal development, therefore, is assigned a high priority in the Bank's strategy.

In other sectors, such as tourism, health and housing, the Bank will seek investment opportunities, consistent with its operational mandates and overall objectives, on a case-by-case basis.

Bank operations
Petőfi Nyomda Rt
In September, the Bank approved its first private sector loan of DM 10 million (ECU 4.91 million) to Petőfi Nyomda Rt, a packaging material manufacturing company, to help finance the modernization of production processes, the expansion of production capacity and improvements to product quality and customer services. The implementation of this investment programme is expected to assist Hungarian products, using Petőfi's upgraded standards of packaging, to become more competitive in western European markets.

Hungarian Telecommunication Company
The Bank also approved a loan of DM 185 million (ECU 90.38 million) to support the Hungarian Telecommunication Company's ongoing modernization and expansion programme. The loan will finance the entire foreign exchange component of the Budapest
and Village development project which is an integral part of HTC's three year core development programme. The objectives of the project, which is estimated to cost a total of ECU 187 million, are to improve the accessibility and the quality of telecommunications services, as well as the efficiency of the telecommunications system in Budapest and in selected rural areas. The project design, which supports the development of a basic network necessary for competitive value added services, is also seen as facilitating the future privatization of telecommunications services.

Hungary is also expected to benefit from the NMB/EBRD Central Europe Agency Credit Line, approved in September. (See operations under Poland for further details.)

Microsystem Rt

In December, the Bank approved an equity investment of US$3 million (ECU 2.24 million) in Microsystem Rt, a private Hungarian company engaged in assembly, distribution and retailing of office automation equipment. The main objectives of this investment are to catalyze additional funding in the company from international equity investors and to support an indigenous company providing fundamental business services to the public and private sectors of the economy.

Technical assistance

The Bank's technical assistance operations in 1991 were geared mainly toward the financial and banking sector. Technical assistance of ECU 76.400 was provided with the aim of establishing an interbank Giro clearing system which is expected to start its operations in April 1992.
Poland

Country review

Key facts

Area (square kilometres) 312,685
Population in millions (1989) 38
Sectoral shares in Total employment (1989) Agriculture: 27% Industry: 37%
Cars per 1,000 inhabitants (1987) 74
Telephones per 1,000 inhabitants (1987) 122
Infant mortality per 1,000 live births (1988) 16
Life expectancy in years (1989) 71
Eligible male labour force participation (1988a) 63%
Eligible female labour force participation (1988a) 65%
Workforce with secondary/higher education 25%
Estimated GDP per capita (1990), in US$ 4,000*

*See "measurement problems" on page 33.
Sources: OECD Secretariat, UN Economic Commission for Europe, European Bank estimates PlanEcon

Political

Poland's political reform began with the birth of the Solidarity independent trade union in 1980, under the leadership of Lech Wałęsa, then an electrician at the Gdansk shipyard. Ten years later, he was democratically elected President of Poland.

In 1989, Solidarity intellectual Tadeusz Mazowiecki formed Poland's and the region's first non-communist government since 1948. The economic shock therapy applied by that government, under the leadership of Finance Minister Leszek Batska, drew international support but domestic criticism that not enough was being done to mitigate the social costs. This debate continues.

Solidarity's Jan Bielecki, a thirty-nine year old economist, became Prime Minister in January 1991, leading a transitional government largely made up of young technocrats, pending free, multiparty democratic parliamentary elections. These were delayed for almost a year, whilst politicians struggled with issues such as the scope of presidential power and the form of electoral law. During this time, because, unlike the Sejm, the President had been popularly elected, 1991 saw an enhancement of presidential powers. Adopting a new constitution which will define presidential and parliamentary powers is among the first tasks before the new parliament.

During 1991, the Solidarity movement split into three principal parties: the Centre Alliance party, the Democratic Union and the Liberal Democratic party. Elements of the communist party, which voted itself out of existence in 1990, regrouped as the Democratic Left.

Poland's first free parliamentary elections since World War II were held on 27 October 1991. There was low voter turnout, and no single party received more than 13 per cent of the vote. The centre-left Democratic Union came first and the Democratic Left second. In the aftermath of these inconclusive elections, free centrist parties, including the Centre Alliance and the Liberal Democrats, agreed to participate in a government led by the Centre Alliance's Jan Olszewski, who was appointed Prime Minister on 6 December 1991. The Olszewski government indicated it would modify economic reforms in response to growing unemployment and economic distress.

In foreign policy, Poland sought in 1991 to strengthen relations within Europe. The Polish government signed an Association Agreement with the EC in December 1991. It joined the Council of Europe. With the CSFR and Hungary, Poland signed the Declaration of Visegrad expressing a common commitment to overcome the divisions of Europe and to cooperate in establishing democracy and market economies. Poland is a member of the Hexagonale, comprising Austria, the CSFR, Hungary, Italy and Yugoslavia. Warsaw is the seat of a new CSCE unit for the promotion of democracy.

Economic

In 1991, Poland experienced severe adjustment problems with a deepening recession, falling real incomes and mounting unemployment as the effects of the economic transformation programme, begun two years earlier, continued to work their way through the economy.

The weak performance of state-owned enterprises, most of which had not adapted to the newly-created competitive environment, remained a fundamental problem. In spite of a 14 per cent devaluation in May and a strong increase in exports to EEC countries, the trade balance turned into deficit because of a higher level
of imports of consumer goods and a 
shift to energy imports at international 
prices. The collapse in trade with the 
former Soviet Union also exacerbated 
the situation. As a consequence, 
public revenues, heavily dependent 
upon taxation generated from 
enterprises, fell dramatically just as 
chips on expenditure were rising 
significantly. In 1991, the 
unemployment rate doubled to 12 per 
cent and GDP declined by 10 per 
cent. The state-owned sector, an 
estimated 70 per cent of the economy, 
contracted by 17 per cent (following a 
fall of almost 20 per cent in 1990) 
with industry and construction 
continuing to be the worst 
affected areas.

Given the disparity in size between 
the state-owned and private sectors, 
the growth in private activity in 
response to the new framework was 
eclipsed by the much larger fall in 
output in the public sector.

Nonetheless, private sector activity 
continued to expand by an estimated 
16 per cent in 1991, producing total 
growth, concentrated in retail and 
small business, of around a third 
over the last two years. The agricultural 
sector delivered negligible growth in 
1991, after a three per cent rise in 
output in 1990. Domestic demand 
contracted further following the 20 per cent decline recorded in 1990.

Real wages fell by around 20 per cent, 
leaving real wages at around 50 per 
cent of 1989 levels. Both gross 
investment and consumption declined 
by an estimated 10 per cent.

The economic contraction and fall in 
real revenue generation coupled with 
mounting claims on expenditure for 
unemployment payments, pension 
provisions, health, education, 
infrastructure and the environment, 
pushed severe pressure on the 
government budget. The unforeseen 
collapse of tax revenues derived from 
state-owned enterprises, which 
previously accounted for about 40 per 
cent of total tax revenues, 
strongly contributed to a budget deterioration 
from an anticipated small deficit 
below one per cent in 1991 to a deficit 
estimated to be equivalent of four per 
cent of GDP.

Environmental

The major environmental problems 
in Poland relate to pollution of air, 
water and land and to their impact on 
valuable resources such as agricultural 
land, forests and minerals.

Air is polluted mainly by emissions 
from the burning of coal and lignite in 
power stations, industrial plants and 
domestic heating. The worst air 
pollution is associated with the use 
of hard coal in Katowice and 
neighbouring voivodeships (local 
authorities), lignite in Jelenia Gora 
(from local sources and from nearby 
Germany and the GDR) and both 
fuels in a number of other cities.

Water pollution results from excessive 
dumping of wastes, pumping of saline 
water from mines and inadequate 
water waste treatment in the mainly 
southern industrial areas. However, 
the effects on the waters of the Vistula 
and Oder rivers are such as to create 
a zone of "ecological disaster" as far 
away as Gdańsk.

Land resources are particularly 
damaged by the dumping of solid 
wastes. Together with air pollution, 
this is a major element of the acute 
environmental problems of the copper 
mining and smelting district of 
Legnicko-Glogow.
The Bank is providing technical assistance to the Polish Social Insurance Fund (ZUS) which is in need of urgent modernization. New computerized filing systems will take over from the old and staff training will all contribute to a more efficient handling of claims and rent payments.
Strategy

On 23 September 1991, the Board of Directors adopted a strategy for the Bank's work in Poland. The strategy focused on the provision of technical and financial support for three main activities:

- privatization and the restructuring of state-owned enterprises and banks (as well as financial support for selected private enterprises in priority sectors),
- modernization of the banking and financial sector in general and the promotion of specialized financial institutions and retail banking services, with particular emphasis on the needs of the small and medium-scale sector, and
- environmental rehabilitation and environmentally-oriented energy-related programmes as well as support to modernize, stabilize and privatize the energy sector.

Privatization

The Bank's short-term strategy in the area of privatization and restructuring will emphasize activities in the following areas:

- support for the establishment of local privately-owned intermediaries,
- the establishment of private on-lending facilities with reputable foreign commercial banks to distribute senior, hard currency debt to qualifying companies,
- the provision of direct funding and technical assistance for enterprises with good operating ratios and capable management, and
- the provision of contractual technical assistance to develop privatization and restructuring plans for selected large-scale enterprises.

In terms of direct promotion of the private sector, in addition to general, on-going advice and support to the government on private sector development, the Bank's initial focus will be through:

- the direct provision of debt, and, on a case-by-case basis, quasi-equity to local enterprises with credible business plans, strong management and significant hard currency earnings,
- the co-financing of foreign direct investment (loans and equity) transactions, particularly in the financial, industrial, telecommunications and agricultural sectors, and
- the provision of advice through mechanisms such as the Polish Business Advisory Services (PBAS) to medium-sized companies in formulating business plans, obtaining assistance to secure financing and accessing management consulting services.

Financial sector

In the financial sector, the Bank's strategy will be 'institution-oriented', that is, the Bank will work closely with foreign banks and emerging local private banks to encourage foreign joint ventures (with Bank participation) to upgrade the quality of banking services. Support to public sector financial institutions will also be considered provided that they are commercially-oriented and that their objective is to support a growing private sector.

The Bank may also become a participant in one or more domestic investment banks and investment funds of proven merit and potential, in partnership with foreign and local institutions. It will also assist in financing non-bank financial institutions.
<table>
<thead>
<tr>
<th>Funding</th>
<th>ECU million</th>
</tr>
</thead>
<tbody>
<tr>
<td>European Bank lending</td>
<td>37.29</td>
</tr>
<tr>
<td>Anticipated syndicated lending</td>
<td>0</td>
</tr>
<tr>
<td>European Bank committed</td>
<td>37.29</td>
</tr>
<tr>
<td>Other lenders</td>
<td>29.83</td>
</tr>
<tr>
<td>Total lending</td>
<td>67.12</td>
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<tr>
<td>Other equity investment</td>
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<tr>
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<td>0</td>
</tr>
<tr>
<td>Total project investment</td>
<td>67.12</td>
</tr>
</tbody>
</table>

Project name: Bank of Poznań (WBK)  
Sector: District heating enterprises  
Type: Loan  
*Government guaranteed

District heating control room and pumping station
Environment
The Bank’s approach in support of Poland’s environmental programmes will focus on the following main areas:
1. Support for policy upgrading and the development of a decentralized environment management system;
2. Implementation of the proposed debt-for-environment swap fund (in this context the Bank will host an international conference on this initiative in early 1992);
3. Financial support for regional environment projects linked to Poland, e.g. Baltic Sea, Sulphur Triangle and Upper Silesia;
4. Financial support, through lending operations, for the environmental priorities of the National Environmental Policy;
5. Financial support for the development of environmental goods and services industries in the country, and
6. Technical assistance for environmental protection integrated in specific projects, e.g. waste water, waste management, air pollution control and land reclamation.

Infrastructure
Severe problems and constraints exist in infrastructure. Since telecommunications are crucial for the functioning of a market economy, the Bank will pay particular attention to the financial requirements of this sector. In the transport sector, the Bank will focus on those attempts to promote private sector participation, in particular, through the use of financing techniques such as Build, Operate and Transfer (BOT) schemes.

Appropriate projects, as they emerge, will also be considered on a case-by-case basis in other important sectors such as agriculture and agro-industry, housing, municipal and urban development, health, tourism and education. Training will be integral to the Bank’s strategic approach, particularly in connection with financial sector reforms and the management of privatized companies which do not yet possess the necessary skills to operate in a market environment.

Bank operations

Bank of Poznan
On 25 June 1991, the Bank approved its first loan of US$ 94.0 million (ECU 87.20 million) to the Bank of Poznan (WBK) for co-lending to several heating enterprises and other enterprises with privatization potential involved in the production and sale of heat and steam. The objectives of the project supported by the loan, with parallel co-financing by the World Bank, are to support the implementation of a comprehensive heating sector restructuring programme; extend the life of existing assets through rehabilitation and the introduction of modern technologies; encourage energy conservation; and reduce environmental pollution.
A Polish waste water treatment plant.
The Bank is advising on investment programme
preparations for waste water collection and
treatment, and clean water supply in a number of
Polish cities.
Lodom
On 26 November 1991, the Bank approved a loan of US$ 2.2 million (ECU 1.64 million) to Lodom, a Polish joint venture created to build and operate a cold storage facility in Szczecin. Lodom is a joint venture between the Polish American Enterprise Fund, Mostostal Panel Company, a Polish-US joint venture, and Przedsiębiorstwo Rolno-Przemysłowe w Szczecinie, a Polish government-owned company on the verge of privatization.

Polska Telefonia Komórkowa (PTK)
On 26 November 1991, the Bank approved a loan of US$ 60 million (ECU 44.75 million) to Polska Telefonia Komórkowa (PTK), a Polish joint venture created to build and operate a countrywide cellular telephone network. The loan will help finance the construction of an NMT 450 cellular network and the purchase of network equipment. Other lenders will be invited to participate in the loan. The partners in the joint venture company, which is expected to be fully operational by mid-1992, are: the Polish PTT, France Telecom Mobiles International, and Ameritech International.

Technical assistance
The following principal technical assistance operations were approved in 1991:
- Consultancy assistance to the Ministry of Finance to help formulate the detailed structure of a deposit insurance system. European Bank financing totals ECU 153,800.
- Investment programme preparations for waste water collection and treatment, including sludges, and clean water supply for the city of Gdansk, for a total of ECU 115,000.
- Polish social security seminar identification study (ECU 48,600).
- In conjunction with the IFC, the Bank set up the Polish Business Advisory Service (PBAS). The PBAS provides financial and business advice and services to the medium-sized business sector in Poland. The Bank has committed ECU 2,200,000 to this project.
- Feasibility study for Polish Mutual Fund for privatization (ECU 55,800 committed).
- Advice on restructuring of textile company in Łódź (ECU 2,400 committed).
The Bank also provided assistance to the Ministry of Privatization through the provision of five key advisory positions to facilitate the Ministry's mandate to carry forward the transformation of the country's economy to private enterprise. Funding will be provided under the EC PHARE Programme.

**Resident office**

The Bank's resident office in Poland will be operational from 15 January 1992, at the UJM Centre-Mariott, Room 15.14, Al. Jerozolimskie 65/79, 00-097 Warsaw. Tel: (48) 2 630 7275, Fax: (48) 2 630 6551.
Romania

Country review

Key facts

Area (square kilometres) 237,500
Sectoral shares in total employment (1989): Agriculture 28%, Industry 45%

Cars per 1,000 inhabitants (1987): 11
Telephones per 1,000 inhabitants (1987): 111
Infant mortality per 1,000 live births (1988): 25
Life expectancy in years (1990): 69
Eligible male labour force participation (1980s): 83%
Eligible female labour force participation (1980s): 68%
Estimated GDP per capita (1995), in US$: 3,000*

*See 'measurement problems' on page 33
Sources: OECD Secretariat, UN Economic Commission for Europe, European Bank estimates, PlanEcon

Political

Romania endured one of the harshest totalitarian regimes for many years. Because central control was so extreme, the effort required to achieve radical change is greater than in other central and eastern European countries. Nonetheless, in 1991, the international community judged that Romania’s progress toward democracy and a market-based economy was sufficient to warrant substantial economic assistance. The Romanian parliament passed a comprehensive and ambitious privatization law, a liberalized foreign investment law and a land reform law. A violent miners’ protest against the impact of economic reforms provoked the resignation of Prime Minister Petre Roman’s National Salvation Front (NSF) government in September 1991. Prime Minister Teodor Stoian, an independent who took office in October, continued to pursue economic liberalization. The new cabinet included other independents and representatives of the main political parties. New elections are planned for spring 1992.

The new Constitution of Romania, on which international constitutional law experts advised, was agreed late in 1991. It provides for a range of democratic rights, including freedom of conscience and religion, expression and the press. Group and minority rights are formally guaranteed but the Hungarian ethnic minority in Transylvania continues to have strong reservations about the extent to which these rights will be safeguarded in practice.

More than 200 Romanian political parties and organizations were active in 1991. The NSF and a number of opposition parties signed the multiparty Charter for Reform and Democracy in June 1991. Strong differences between the NSF reform and conservative factions point to the possibility of an NSF split in the future.

Trade unions are now autonomous but fragmented. A growing number of Romanian societies and associations are also emerging and beginning to influence public opinion. Freedom of the press is generally respected, but the media are constrained by economic difficulties. There are efforts by the opposition to set up a privately-owned TV channel as an alternative to the state service.

The government’s foreign policy objective in 1991 was to reintegrate Romania into European political life. Romania signed the Cultural Convention of the Council of Europe, which may lead to future membership of the Council. Romania also played a very constructive role as a member of the UN Security Council in 1990-91.

Economic

In 1991, Romania continued to suffer from declining output, rising unemployment, and falling real income. Real GDP is estimated to have declined by around 10 per cent following a drop of about 15 per cent over the previous two years. The rise in registered unemployment, to 3.5 per cent, does not reflect demand conditions as companies were pressured by trade unions to maintain employment. The OECD has estimated 6 per cent to be a more plausible figure of underlying unemployment.

Prices are estimated to have risen on average by 160 per cent in 1991. Attempts to recover part of the real wage loss led to substantial wage increases, which fuelled inflation. External accounts showed no improvement despite repeated devaluations of the currency. Exports declined by 10 per cent and current account deficit was estimated to be US$ 2.4 billion.
The government has steadfastly maintained its reform course, despite the fall in real income and pronounced shortages of certain items of food and other basic commodities. Prices were liberalized progressively beginning October 1990, and price controls no longer remain for goods representing about 20 percent of output to the market, comprising mining products and basic consumer goods. The authorities introduced full internal convertibility of the currency, with effect from 11 November 1991.

Rapid progress has been made in creating the legislative framework for a decentralized market-based financial system. Following the introduction of the two-tier banking system in February 1990, laws governing the central bank and commercial banks were enacted in April 1991, and bankruptcy laws have been drafted and were pending consideration by parliament.

A comprehensive privatization law was passed in August 1991. Ownership will be divided into private and public hands in a ratio of 3 to 1, where private ownership will be given to citizens and managed through funds, and the public share will be controlled by the State Ownership Fund. A number of companies will be privatized separately, precluding the general privatization process.

In agriculture, which employs 25 percent of the total population, privatization started early in 1991 under the Land Reform Law. About five million people have been registered for return of land they originally owned. It is expected that 70 percent of agricultural land will be privatized by the end of 1992.

However, restructuring of state enterprises is proving to be difficult. Shortages of energy and raw materials and continued lack of access to foreign financing hindered attempts to restructure. Despite a liberal regime for foreign direct investment and a steadily rising number of joint ventures, foreign capital inflows were limited.

Environmental

The limited quality and quantity of data available indicate that environmental degradation in Romania results both from heavy industry operating with limited pollution control and from high-intensity agriculture, carried out without the benefits of environmental management.

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<tr>
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</thead>
<tbody>
<tr>
<td>GDP at constant prices (% change)</td>
<td>-0.5</td>
<td>-5.8</td>
<td>-7.4</td>
<td>-10.0</td>
</tr>
<tr>
<td>Unemployment as % of labour force</td>
<td>-</td>
<td>-</td>
<td>2.0</td>
<td>6.0</td>
</tr>
<tr>
<td>General government balance (% of GDP)</td>
<td>-</td>
<td>8.4</td>
<td>0.6</td>
<td>-</td>
</tr>
<tr>
<td>Consumer prices (% change)</td>
<td>2.2</td>
<td>1.1</td>
<td>5.1</td>
<td>100.0</td>
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<tr>
<td>Units domestic currency per US$ (end-year)</td>
<td>14.0</td>
<td>14.0</td>
<td>35.0</td>
<td>289.0</td>
</tr>
<tr>
<td>External current account (US$ million)</td>
<td>3825.0</td>
<td>2884.0</td>
<td>1859.0</td>
<td>2400.0</td>
</tr>
<tr>
<td>Gross external debt (% of exports of goods and services)</td>
<td>26.3</td>
<td>25.5</td>
<td>48.4</td>
<td>-</td>
</tr>
</tbody>
</table>

Selected economic indicators for Romania

*Weighted average of prices of goods and services sold by state enterprises and cooperatives and prices at the four peasant markets (through end-1990; q3 1991); **End-year, convertible currencies only; ***Data not available

Sources: Data provided by national authorities and European Bank estimates
Strategy

The Bank's initial strategy on Romania was endorsed by the Board of Directors on 28 October 1991. It will focus on the following:

Main priorities
- privatization and restructuring of state-owned enterprises and promotion of small business development,
- financial sector reform and bank restructuring,
- infrastructure development, including transport, telecommunications and the rehabilitation of energy production and distribution, and
- agriculture support services and the financing of agricultural inputs and implements.

Other possible operations
- environmental protection and rehabilitation, and
- municipal development.

Privatization and enterprise restructuring
The Romanian government is making significant progress in developing a new legislative and institutional framework for a market driven economy based on private ownership of productive capacity. The Bank expects to participate in the privatization process both through ongoing technical assistance to the National Agency for Privatization (NAP) and, in due course, through assistance to and participation in specific privatization transactions.

Financial sector reform and bank restructuring
Considerable technical assistance is required urgently to develop the systems and skills necessary for an efficient financial system. In particular, supervisory and regulatory bodies need to be strengthened to ensure that the financial sector develops in a prudent and transparent manner. In the near term, therefore, the Bank's activities will focus on technical assistance in the financial sector in an effort to promote or hasten the advent of conditions which will support a broader programme of loans to and investments in financial institutions.

Infrastructure
Transport The Bank, in its efforts to integrate central and eastern European countries with the international economy, can assist with the realization of Romania's transport arteries. In the process, the Bank would also be able to assist with the policy framework to move the transport sector toward a market-oriented structure with increased private participation in the delivery of transport services. The Bank's overall transport sector strategy will be to support:
- the development of inter-European transport arteries,
- the gradual elimination of domestic transport bottlenecks, and
- the streamlining of the legislative framework to achieve an efficiently functioning transport system.

Energy
The present energy policy in Romania aims to restore oil and gas production and to put greater emphasis on energy efficiency as part of the transition to a market economy. The new policy will seek to curb declining domestic production while improving the overall management of each energy subsector.
The Bank’s priorities would provide support to:
- establish a market-oriented energy sector which, through its physical restructuring and a phased pricing reform, is more specifically related to the country’s conditions and costs,
- improve the efficiency with which energy is produced, distributed and used, partly through enhancement of existing facilities for turbine and generation production, and the improvement of management practices,
- promote regional integration, including the development of gas pipelines and the interconnection of the Romanian electricity grid to western networks, and
- to enhance environmental standards and reduce pollution through specific measures including the promotion of European safety standards,
- improve access to commercial credit through the provision of an agricultural credit line to a suitable financial intermediary.

Environment
The degree of environmental degradation in Romania is such that, to be effective, any intervention must tackle the problems in an integrated manner. This would require the development by the government, assisted by the Bank if requested, of an environmental management system that fully adopts international standards and would include:
- development of an environmental strategy for the country as part of the overall economic programme,
- design of a system for environmental protection and financing of environmental projects,
- establishment of environmental standards and the framework for monitoring and enforcing these standards,
- industrial environmental audits as part of an investment package that the Bank might undertake,
- water quality management, and
- an air pollution control programme for the power sector, for chemical and petrochemical industries and for the mining sector.

Bank operations
Rom Telecom
On 16 December 1991, the Bank approved a loan of ECU 142 million equivalent, in various currencies, to Rom Telecom (RT) with Romania as a guarantor. The investment objectives are to enable the telecommunications sector to play its role in the overall reform and development of the Romanian market economy. Specifically, the project will provide efficient and effective telecommunications services, starting with
selected investments designed to relieve the overall system congestion and to achieve a rapid improvement in telecommunications services for business subscribers. At the same time, the project seeks to facilitate the transformation of the newly established RT into an autonomous commercial organization which could be readily privatized.

The project comprises:
- construction of a long-distance overlay digital network, together with the expansion of international capacity and provision of local networks capable of connecting 600,000 new subscribers to these new facilities, and the replacement of 400,000 worn out lines,
- technical assistance for measures to improve the management, efficiency and financial performance of RT.

**GEC Alsthom/IMGB joint venture**

On 18 December 1991 the Bank committed loan finance of ECU 23 million over two phases to a newly established joint venture between GEC Alsthom Group (GEC Alsthom) and Intreprinderea de Masini Grele Bucuresti (IMGB), a Romanian heavy equipment manufacturer. The joint venture will apply the technology and management expertise of GEC Alsthom to the rehabilitation of existing IMGB plant, which is operating currently at less than half of its full production capacity. The plant will produce high quality turbines, generators and condensers for power stations. A significant proportion of its product will go toward the rehabilitation of the electrical generation capacity of the Romanian electrical utility RENEL which, itself, is operating significantly below capacity. Increased domestic electrical production would have major hard currency and economic benefits for Romania.

**Technical assistance**

The Bank has assisted the National Agency for Privatization in implementing its programme of ‘early privatization’ by helping to design terms of reference and to select consultants for the preparation of:
- detailed guidelines and procedures for the sale of shares and assets to ensure transparent and fair implementation of the Privatization Law (58/1991),
- a list of 30 companies to be sold as well as a list of assets, and
- a standard methodology and criteria for the evaluation of privatization proposals and for the sale of assets.

In conjunction with the loan to Rom Telecom, the Bank has also provided technical assistance concerning sectoral development and commercialization of Rom Telecom. Financing for two technical assistance projects totalled ECU 595,300.

**Resident office**

Discussions to secure premises for a resident office are at an exploratory stage.
USSR
Country review

Key facts

Area (square kilometres) 22,400,000
Population in millions (1989) 286
Sectoral shares in total employment (1989) Agriculture 19%, Industry 39%
Cars per 1,000 inhabitants (1987) 50
Telephones per 1,000 inhabitants (1987) 124
Infant mortality per 1,000 live births (1988) 25
Life expectancy in years (1989) 70
Eligible male labour force participation (1980s) 81%
Eligible female labour force participation (1980s) 73%
Workforce with secondary/higher education 27%
Estimated GDP per capita (1990), in US$ 5,000

*See ‘measurement problems’ on page 33
Sources: OECD Secretariat
UN Economic Commission for Europe
European Bank estimates
PlanEcon

Political

1991 was the most turbulent and the last year in the USSR’s history. When Mikhail Gorbachev became General Secretary of the Communist Party of the USSR in March 1985, he launched a reform process called perestroika which envisaged a radical reshaping of the existing command system while strengthening both the USSR and socialism. Under the slogan of glasnost, the policies of Stalin and other previous leaders of the country were subjected to fierce criticism, political prisoners were released and religious freedom greatly extended.

As the events of the second half of 1991 demonstrated, the initial reforms, such as the revision of the 1977 Constitution, which opened the way to multiparty democracy, unleashed new forces. Hardliners in the Soviet leadership grew increasingly alarmed at emerging threats to the unity of the country. On 19 August 1991, they staged a coup d’état which quickly failed.

The changes in the political environment were so far-reaching that they hastened the demise of the communist system, including the Communist Party. The role of the Union was rejected in the light of the nationalist aspirations of some republics. All three Baltic States formally declared independence and the restoration of their sovereignty was internationally recognized.

The dismantling of the USSR began formally on 2 September 1991, when Gorbachev and the leaders of 10 Union republics declared their intention to create a confederation in which each republic would define independently its participation.

There followed several attempts to preserve the Union in some form by means of an economic agreement and a political union treaty.

However, in the last months of 1991, the disintegration of the centre was hastened by the severely deteriorating economic and social situation. Ukraine voted overwhelmingly for full independence. It then joined with Russia and Belarus in signing an agreement in Minsk on 8 December 1991 to establish a Commonwealth of Independent States (CIS).

By the end of the year, 11 of the 12 remaining republics (Georgia being the exception) had signed the Minsk Agreement. On 26 December 1991, a day after President Gorbachev resigned, the last session of the Council of the Union of the Supreme Soviet adopted a formal declaration on the dissolution of the USSR.

The Agreement establishing the CIS included the commitment of member states to the goals and objectives of the Charter of the United Nations, Helsinki Final Act and to other CSCE documents, to equal rights and freedom to their citizens, respect for territorial integrity and freedom of cross-boundary movement. Members also undertook to retain a united command of common military strategic space and joint control of nuclear weapons. Coordination of foreign policy, the development of a common economic space, cooperation in environmental protection and the fight against organized crime were identified as falling under the joint competence of the CIS.

The creation of the CIS allayed the immediate threat of violence. By the end of 1991, several republics had gained widespread international recognition of their independence.

There is still reason to fear, however, that if democratic forces fail to act rapidly and effectively, the public mood might turn from frustration to despair. In that event, the euphoria of the August victory might turn into
chaos or dictatorship. Future prospects depend upon the political will of those concerned.

Economic

In 1991, all the macroeconomic performance indicators of the Soviet economy deteriorated to an unprecedented extent. The steep recession was coupled with the breakdown of the financial and monetary system. The consolidated Union-Republic budget deficit exceeded 20 per cent of GNP, and the growth of wages and the money supply got out of control, with the combined result that galloping inflation was already close to hyperinflation by the end of 1991. A further indication of this trend was the erosion of the rouble’s purchasing power. Its auction rate fell from R1 22 to 25 per US$ in January 1991, to R1 100 - 110 in November and to R1 140 - 150 in December 1991.

Foreign trade plummeted, especially with the former CMEA partners, following the switchover to a hard currency payment system effective from 1 January 1991. (In the first three quarters of 1991, Soviet exports to ex-CMEA countries declined by 56.8 per cent and imports declined by 60 per cent). Debt service requirements and government and commercial loan principal and interest, amounted to US$ 4.5 billion at year end 1991. Despite the debt deferrals agreed on with both official and private creditors, the successor states of the USSR faced a deepening balance of payments crisis, with official foreign exchange reserves depleted to a level of US$ 105 million by mid-December.

In late October 1991, a programme of drastic economic reforms was undertaken by the Russian Federation. This Polish-type shock therapy programme envisaging harsh macroeconomic stabilization measures and a swift transition to a market-based economy meant a drastic change in the reform process of the Soviet economy. Price liberalization - the cornerstone of the stabilization and reform package - was planned to be launched on 2 January 1992, and would force a growing number of the other former republics to follow suit.

The unilateral Russian reform steps were partially motivated by the impracticability of rapid and coordinated reforms within the framework of the Treaty on Economic Community. The CIS was created in order to prevent the possible catastrophic consequences of complete disintegration.

Environmental

The former Soviet Union suffers from widespread pollution and environmental degradation, depletion of natural resources, poor or non-existent environmental management practices in industry and from the effects of environmental accidents. Since the Chernobyl accident, the effects of which are still being studied, the safety aspects of Soviet-designed nuclear power plants have come under increased scrutiny. Here, however, as in other environmental areas, there is a pervasive lack of environmental information and accurate data.

It is estimated that 62 million tonnes of primary air pollutants are produced by industry and 36 million tonnes by mobile sources each year.

Water pollution is widespread and results from excessive use of chemicals in agriculture (pesticides and fertilizers), from industrial waste water and from the lack of municipal waste water treatment plants.

Although no data exist on hazardous waste, it is estimated that more than 20 million tonnes of hazardous waste are produced each year (more than that of the entire European Community).

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<tbody>
<tr>
<td>GNP at constant prices (% change)</td>
<td>5.50</td>
<td>3.00</td>
<td>-2.00</td>
<td>-12.00</td>
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<tr>
<td>Unemployment as % of labour force*</td>
<td>0.00</td>
<td>0.00</td>
<td>0.00</td>
<td>0.00</td>
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<td>Consolidated budget balance (% of GDP)</td>
<td>10.30</td>
<td>10.00</td>
<td>6.18</td>
<td>20.00</td>
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<tr>
<td>Consumer prices (% change)</td>
<td>0.50</td>
<td>2.00</td>
<td>5.30</td>
<td>91.00</td>
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<td>Units domestic currency per US$ (end-year)**</td>
<td>0.51</td>
<td>0.63</td>
<td>0.77</td>
<td>0.73</td>
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<td>External current account (US$ billion)***</td>
<td>1.67</td>
<td>-3.30</td>
<td>-2.90</td>
<td>5.00</td>
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<tr>
<td>Gross external debt (% of exports of goods and services)***</td>
<td>118.1</td>
<td>144.8</td>
<td>144.1</td>
<td>177.1</td>
</tr>
</tbody>
</table>

Selected economic indicators for the USSR

* Officially registered unemployment
** Official commercial exchange rate
*** End year, convertible currencies only

Sources: The Institute of International Finance and Goskomstat
To support financial infrastructure in these emerging economies, the Bank has provided assistance in the formation of a network of schools for training in finance, banking and enterprise management. The first schools will be operational in St Petersburg and Moscow.
**Action plan**

Due to the increased instability and unpredictability of the former USSR's political, economic and social situation, the Board decided not to endorse a long term strategy in 1991. The Board approved a short term Action Plan for the former Soviet Union at its meeting on 4 September 1991. In addition to the Bank's general objectives, the main considerations and goals of the Action Plan were to:

- comply with the specific provisions of the Agreement Establishing the Bank,
- address vital areas in the transition to a market-based economy which respond to the most urgent reform needs and are, at the same time, largely independent of the general political and economic instability,
- focus initial operations on technical assistance, combined with some loan and equity participation to help establish private sector institutions and develop infrastructures conducive to a market economy,
- ensure close cooperation with the IMF, World Bank, EC and the OECD in the different areas of assistance to be provided to the former USSR,
- implement a balanced approach in providing assistance to various levels of governments and different geographical areas,
- concentrate Bank operations in the former USSR on areas where the Bank can most effectively utilize its own resources, as well as grant finance available through Technical Assistance Cooperation Funds and through co-financing arrangements, and
- maintain flexibility and openness of the Bank's programme in order to be able to adapt to the swiftly changing circumstances.

On the basis of the above criteria and considerations, the short term Action Plan identified the following priority areas:

**Privatization and enterprise promotion**

The Bank will provide assistance for privatization and enterprise promotion through advisory assistance and training. Advisory assistance is to be directed toward the government of the republics and the municipalities. It is also to be provided to several state enterprises which are introducing modern management techniques and are in the process of corporatization. Privatization training has two major aspects. A series of privatization courses is being designed to provide training for privatization managers, both in the republics and abroad. The establishment of a permanent privatization training institute is envisaged.

**Financial sector**

Bank assistance to the financial sector will focus on the commercial banking, the securities markets and the insurance industry, each of which is seriously inhibiting the development of the fledgling financial sector.

**Agricultural distribution**

The Bank's Action Plan includes three pilot projects for the creation of wholesale markets with upgraded storage, food-processing and transport facilities in the rural regions surrounding Moscow and St Petersburg. These pilot projects are intended to provide the necessary experience to permit the subsequent establishment of a wider network of wholesale markets.

**Energy**

The Bank's operations in this sector will be consistent with the European Energy Charter and will focus on projects and programmes which produce immediate
<table>
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<tr>
<th>Funding</th>
<th>ECU million</th>
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<tbody>
<tr>
<td>European Bank lending</td>
<td>3.58</td>
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<tr>
<td>Arranged syndicated lending</td>
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<tr>
<td>European Bank committed</td>
<td>4.85</td>
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<tr>
<td>Other lenders</td>
<td>0</td>
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<tr>
<td><strong>Total lending</strong></td>
<td><strong>4.85</strong></td>
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<tr>
<td>Other equity investment</td>
<td>5.44</td>
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<tr>
<td>To be sourced</td>
<td>0</td>
</tr>
<tr>
<td><strong>Total project investment</strong></td>
<td><strong>10.29</strong></td>
</tr>
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</table>

A number of business centres and hotels have been connected using the Enhanced Digital Network international gateway switch allowing first class international telecommunications, essential for business. The Bank is helping to finance the installation and operation of this system.
hard currency earnings or address vital safety issues. The Bank's priorities are to finance and to stimulate private investments in projects in the oil and gas sector. The Bank's technical assistance programme is aimed principally at implementing improvements in the management of production and distribution, and compliance with environmental and nuclear power generation safety standards.

Bank operations

The Bank's efforts focused on the provision of loans rather than upon equity participation and guarantees. Nevertheless, equity is destined to become an increasingly significant instrument in 1992.

Parker drilling company

A US$ 12.5 million (ECU 9.28 million) loan was agreed to finance the construction and operation of three drilling rigs in western Siberia by a company to be formed as a wholly-owned subsidiary of Parker Drilling Company, a US contract drilling company. The subsidiary of Parker Drilling Company, is to operate the rigs under contract for White Nights Joint Enterprises, which is currently producing around 25,000 barrels of oil per day and thereby generating substantial hard currency revenues. The three additional drilling rigs and other modern oilfield services are expected to boost production to 150,000 barrels a day.

Enhanced Digital Network

A loan of US$ 6.5 million (ECU 4.85 million) was approved to Enhanced Digital Network (EDN), a Russian telecommunications company, to finance the installation and operation of an enhanced international digital telecommunications system in the Moscow area. Commercial banks will be invited to participate in the loan. Under the name of SOVINTEL, EDN will operate a telecommunications system providing high quality, direct-dial international voice, data and facsimile transmission services to Moscow hotels and business centres. Entirely separate from the present Soviet international system, it will be the among the first of its kind in the republics.

Technical assistance

Technical assistance programmes are in preparation and underway in the following fields: privatization, financial sector, agricultural distribution system and municipal services and general policy advice in areas requested by the Russian government.

Privatization

Moscow Municipality privatization programme

The Bank signed an agreement on 24 May 1991, to act as the lead adviser on privatization for the Moscow City Municipality to execute the Initial Technical Assistance Programme (ITAP), a pilot privatization programme designed to formulate advice on privatization methods and to identify sectors and enterprises for early privatization. Advice on legislative policy has been given and a list of enterprises for pilot privatization has been finalized (ECU 1,230,000 committed).

St Petersburg Municipality privatization programme

On 22 October 1991, the Bank signed an agreement with the St Petersburg Municipality to be the lead adviser on privatization. The programme of assistance will comprise:

- general advice on privatization,
- development of a pilot privatization programme,
- establishment of a privatization database, and
- establishment of a foreign investors' centre.
Following the signing of an agreement with the Russian government on 24 May 1991, the Bank delivered core assistance in support of the Republic's privatization programme. First tasks included: a review of Russian privatization legislation, a practical definition of the privatization programme (e.g., methods, enterprise selection) and the identification of enterprises for direct foreign investment (ECU 914,000 committed).

Development of technical privatization manuals and foreign investors' guidelines The manuals will facilitate the process of transformation of enterprises to joint-stock companies and the process of small-scale privatization.

Assistance will be given toward the establishment of an international school for business management and privatization, including the training of staff, curriculum design and logistical support (ECU 1,000,000 committed).

A European Bank/UNDP symposium on small business development will cover the design of policies to promote small and medium-sized enterprises, institution building and development support systems, and mechanisms to secure national and international cooperation to enhance the performance of enterprises.

Financial sector development Assistance will be given toward the establishment of an international school of finance and banking to train professionals in all major aspects of commercial banking, central banking, insurance and the securities market. Assistance will also be given to seven other banking schools in the republics (ECU 2,300,000 committed).

Technical advice will be given to support the development of the government securities market (ECU 7,400 committed). Financial markets training will be provided to senior officers from the Ministry of Finance and from the Central Bank of Russia. Assistance will be given to support training, regulations and rules for operations and automation and computerization for the Stock Exchange. The technical assistance programme will help to develop the legislative environment and training for the insurance industry.

Agricultural distribution
A pre-feasibility study was undertaken to examine the major constraints on agricultural distribution, marketing and pricing. A number of detailed feasibility studies will focus on specific key areas. A feasibility study for a pilot wholesale market, storage development and training, for the Moscow Municipal, the Moscow Region and St Petersburg is in preparation.

Municipal services
Agreement was reached with Moscow City government to conduct a feasibility study for improvements in the solid waste disposal system. Discussions are being held with the St Petersburg city authorities to finalize details for a technical assistance programme to upgrade the city’s water supply and waste disposal systems and to improve the energy efficiency of urban heating systems.

Resident office
The Bank is planning to establish a resident office in Moscow by April 1992.
Yugoslavia

Country review

Political
Yugoslavia has seen steadily worsening civil conflict since the independence declarations of the republics of Croatia and Slovenia in June 1991, despite the efforts of the European Community, and then of the United Nations, to mediate.

Elections in Croatia, Serbia and Slovenia produced strong nationalistic movements. Bosnia-Herzegovina, a republic of mixed ethnic composition which lies between Serbia and Croatia, was relatively untouched by the conflict in 1991 and declared its neutrality and sovereignty.

Montenegro was closely aligned to Serbia throughout. Macedonia, not directly involved in the conflict, declared its independence. The status of the Albanian ethnic population of Kosovo, a province of Serbia, remained sensitive, due to their overwhelming vote, in an unofficial referendum in late 1991, for independence.

After the independence declarations of Slovenia and Croatia violence escalated, especially in relation to the Serbian enclaves in Croatia.

On 8 November, the European Bank’s Board of Directors strongly endorsed President Attali’s decision only to put forward for Board consideration, for the time being and when appropriate, activities with those parties in Yugoslavia contributing to the resolution of the conflict by peaceful means and procedures.

Within the scope of that decision, the Bank provided in 1991 technical cooperation to help with privatization plans in Macedonia, and held discussions with Slovenia on future assistance.

Bank involvement

Technical assistance
Following a request of the President of Macedonia, the privatization team of the European Bank developed a technical assistance project for the Ministry of Privatization. The Bank supported the Economic Advisor to the Government in laying out an initial approach to privatization based on a detailed analysis of the position of the Macedonian economy.

The work lead to a report identifying key steps to be taken in implementing the transition. It describes the restructuring and privatization scheme for state-owned enterprises in Macedonia and includes the identification of specific enterprise candidates for initial privatization.

Selected economic indicators for Yugoslavia

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<tbody>
<tr>
<td>GDP at constant price (% change)</td>
<td>–</td>
<td>0.6</td>
<td>-0.5</td>
<td>-15.0</td>
</tr>
<tr>
<td>Unemployment as % of labour force</td>
<td>–</td>
<td>7.8</td>
<td>8.5</td>
<td>9.6</td>
</tr>
<tr>
<td>Consumer prices (% change)</td>
<td>–</td>
<td>125.0</td>
<td>588.0</td>
<td>118.0</td>
</tr>
<tr>
<td>Units domestic currency per US$ (end-year)</td>
<td>0.5</td>
<td>12.0</td>
<td>11.0</td>
<td>21.0</td>
</tr>
<tr>
<td>Gross external debt (% of exports of goods and services)</td>
<td>–</td>
<td>28.9</td>
<td>25.0</td>
<td>–</td>
</tr>
</tbody>
</table>

Sources: Data provided by national authorities and European Bank estimates

—denotes not available
New member countries

The Board of Directors of the European Bank recommended membership for the Baltic States on 29 October 1991, and the Bank’s Board of Governors approved their membership on 29 November, with the expectation that they will become members early in 1992.

The following summaries describe the political, economic and environmental situation of each of the three States.

Estonia

Political review
The restoration of Estonia’s independence was internationally recognized in August and September 1991. With the advent of glasnost, political groups had formed into two main movements: the Popular Front (predominately former Estonian Communist Party members and sympathizers) and the Congress of Estonia (mainly former dissidents). It is not yet clear how the many embryonic political groupings will develop, now that the unifying aim of independence has been achieved. The Communist Party was banned after the August 1991 aborted coup in Moscow.

Trade unions and numerous associations and interest groups were active in 1991. The media were free, though constrained by the state of the economy. There was freedom of movement, speech and religion. Russians were able to be educated in their own language.

The drafting of a new Constitution was a key political issue in 1991. A working group was established of 60 members from a wide range of political groups. International lawyers assisted in its work and the Council of Europe supplied technical expertise from the Venice Commission for Democracy through Law. A referendum on the adoption of the new Constitution is planned for 1992.

Citizenship was a difficult issue for Estonia in 1991. Of a total population of some 1.5 million, about 60 per cent are ethnic Estonian, while 30 per cent are Russian. Opinions vary as to whether, and on what terms, Estonian nationality should be offered to this substantial minority group.

The Bank hosted a one-day conference in October 1991 on Baltic minorities and citizenship issues, where Justice and Foreign Ministers from the Baltic States held discussions with international human rights experts. A representative of the Russian population in Estonia attended as part of the Estonian delegation. The following month, the Parliament discussed the possibility of restoring the Republic’s liberal 1938 citizenship law. Radical nationalists’ attempts to introduce additional restrictions thus appear to have failed.

Estonia sees itself as a window to the West and has increasingly close relations with the Nordic countries. It is also active in international
organizations such as the UN, the Council of Europe and the CSCE.

**Economic Review**

The Estonian economy is dependent on energy imports from the former Soviet Union, and its textile industry relied on raw materials from Central Asian republics. It therefore faces a substantial drop in living standards, due to the collapse in trade with the former Soviet Union. This disruption in trade was partly responsible for the decline in total output in 1991, estimated at more than 10 per cent. Prices increased rapidly from 1989. In the third quarter of 1991, consumer prices were 270 per cent higher than the previous year.

Estonia's efforts during 1991 to reform its economy included the lifting of price controls on most products; remaining controls will be eliminated in 1992. A new tax system was implemented in January 1991, and unemployment registration and benefits schemes were introduced in April 1991.

Parliament took initial steps toward property and land reform and the restitution of ownership rights, however these proved to be difficult issues. A law on ownership rights, passed in June 1991, enabled privatization programmes to proceed. Major areas of legislation to support a market-oriented economy, including competition and bankruptcy law, are in preparation. Privatization of small business has begun. Privatization of large, state-owned enterprises and parts of the transport sector has been complicated by negotiations with former Soviet republics about ownership of the former All-Union enterprises.

New private entrepreneurship, initially in the form of cooperatives, grew rapidly. Foreign involvement in firms brought significant benefits: 1,200 firms had some foreign involvement in 1991 and, by year-end, joint ventures with foreign partners accounted for a significant share of Estonian exports to the West.

**Environmental review**

Estonia has serious pollution and resource degradation problems, with water pollution in rivers, lakes and the Baltic Sea being the most acute. The main sources of pollution are municipal waste water, industrial waste water and agricultural runoff. There is a serious lack of adequate waste water treatment facilities. In 1989 in Estonia, 47.5 per cent of total waste water discharge in need of treatment was inadequately treated or not treated at all.
Latvia

Political Review
The restoration of Latvia's independence was recognized by the international community in August and September 1991. President Anatolijus Gorbunov had been elected in March 1990. The government in 1991, led by Prime Minister Ivars Godmanis, was one of transition, until plans for new elections and possibly a new power structure centered on either the President or the Prime Minister, could be finalized.

Many political groups were formed in 1991 as the former Soviet Union gradually released its hold. After independence, the political parties, as in the other Baltic States, began redefining their aims. It may be some time before it is clear which will emerge as the strongest. The Communist Party was banned following the unsuccessful August coup in Moscow.

Freedom of the media, speech, religion and movement are in place. Pluralism is assured through numerous bodies ranging from trade unions and professional associations to ecological groups. Russians may be educated in their own language. There are currently over 40 Russian Members of Parliament.

Citizenship was a key issue in 1991. The situation was similar to, but more stark than that of Estonia. Latvia has a population of over 2.5 million of whom 52 per cent are ethnic Latvian, 38 per cent Russian, 4.5 per cent Belorussian and 4 per cent Polish or Ukrainian. Latvians fear becoming a minority group in their own country. There has been a serious debate as to who is entitled to Latvian nationality.

On 16 October 1991, the Latvian Supreme Council adopted a resolution on citizenship which provoked criticism from some international human rights organizations.

The one-day conference on Baltic minorities and citizenship issues, hosted by the European Bank in October 1991, enabled Latvian Justice and Foreign Ministers, together with their counterparts from the other Baltic states, to discuss specific difficulties with international human rights experts. In November 1991, Latvia also received technical advice on constitutional issues from the Council of Europe and the Venice Commission for Democracy through Law.

Since the restoration of independence in September 1991, Latvia has followed a foreign policy based on positive cooperation with its neighbours. It participates in various international fora, such as the Council of Europe, and is a member of the UN.

Economic review
The Latvian economy remained highly integrated with that of the former Soviet Union and retained a high dependence upon energy and raw material deliveries. It is estimated that the introduction of world market prices into inter-republican trade in central and eastern Europe would result in a 25 per cent deterioration of the terms of trade in Latvia and a substantial decline in real income. However, in 1991, industrial production and employment levels remained almost unchanged from 1990 figures. The decline in production in large, state-owned enterprises was largely offset by growth in the consumer and building sectors under Latvian control. With price increases only marginally outstripping wage rises, real incomes were largely maintained.

Transformation of the economy proceeded steadily. Guarantees of individual property rights were reintroduced in August 1990 and private enterprise legislation, including laws on partnerships, state enterprises and limited liability companies, was enacted. A new tax system became effective on 1 January 1991, ensuring full Latvian control over tax revenues.

Most prices, including those of food, transport and communications, were liberalized from 1 December 1991. However, as major suppliers continued to be in a monopoly position, substantial state supervision of prices remained.

Privatization efforts focused initially on the agricultural sector. Cooperatives were asked to re-register as private enterprises. However, overall progress in privatization was fairly limited in 1991.

Environmental review
As in Lithuania and Estonia, water pollution in rivers, lakes and the Baltic Sea is the most acute environmental problem. In 1989, 70 per cent of total waste water discharge in need of treatment was inadequately treated or not treated at all. Riga and Ventspils are the main sources of pollution into the Baltic Sea.

Latvia has no air polluters comparable to Estonia. Seventy three per cent of total emissions of particulates,
Lithuania

Political review
The restoration of Lithuania’s independence was recognized by the international community in August and September 1991. In expectation of this, Lithuania had adopted a provisional constitution as early as March 1990. Proposals for the definitive new Constitution were examined in 1991 and are expected to be consistent with international democratic standards.

With some 3.690,000 inhabitants, Lithuania has the largest population of the Baltic States, and the smallest percentage of minorities: 8-9 per cent Russian and about 7 per cent Polish origin.

Lithuania passed a law in November 1989 giving everyone then living in the country the right to apply for Lithuanian nationality. Amendments allowing Lithuanians who had been living abroad since 1940 to acquire citizenship, were discussed in the Parliament in 1991 but the issue of dual citizenship remained undecided. The 1991 draft nationality law required new citizens to have lived for at least five years in Lithuania, to speak Lithuanian and to have a legal means of earning a living. The 1990 Law on Minorities guaranteed equal protection and the State provides separate schools, with tuition in their own languages, for the main minority groups.

The post-independence parties include the Lithuanian Democratic Workers Party, the Christian Democrats, the Social Democrats and the National Party. None has, as yet, a fully fledged political structure. President Landsbergis and his Prime Minister are both independents.

Freedom of speech, the media, religion and movement is guaranteed. Free trade unions and many other interest groups are actively supported.

Lithuania’s foreign policy is founded on positive cooperation, for both commercial and security reasons, with neighbouring former Soviet republics and with Estonia and Latvia. The Baltic States participate in tripartite councils to share views on common problems. Lithuania has applied for membership of the Council of Europe and is an active participant in the CSCE and other international fora.

Economic review
In 1991, industrial production was about 15 per cent below the 1990 level and agricultural production contracted slightly due to persistent shortages in feed grain. Industrial companies won considerable success in preserving trade and customer contacts, thereby substantially maintaining production and employment levels and avoiding a large rise in unemployment. However, instability in the former Soviet Union, interruptions to supplies and price adjustment in selected commodity imports forced Lithuania to seek emergency assistance.

The 1991 budget was expected to be in balance, as Lithuania retained all income taxes collected in the country and ceased payments to the former Union central budget. More than 60 per cent of government expenditure took the form of subsidies, principally to the agricultural sector.

Although the first proposals for price reform were rejected by parliament, the government liberalized most prices during 1991. A partial wage indexation system was established to protect household real income, but this has tended to undermine efforts to stabilize prices.

Basic economic reform laws, including the restitution and privatization of property, were enacted during 1991. In March 1991, housing became the first sector to be privatized and municipalities quickly assumed responsibility for the
As of May 1991, employees had the possibility to subscribe to 10 per cent of equity in state enterprises turned into joint-stock companies. Legislation provides for privatization via auctions of shares using vouchers, as well as through sales for hard currency. The actual process of privatization has accelerated since September.

Environmental review
Environmental degradation has arisen from the operation of manufacturing industry without adequate environmental control, discharge of untreated waste water and contamination of groundwater due to over-intensive use of fertilizers.

As in the other Baltic states, water pollution in rivers, lakes and the Baltic Sea is the most acute environmental problem. In 1989, 73 per cent of total waste water discharge in need of treatment was inadequately treated or not treated at all.

In 1989, total emissions into the air were estimated at 1 million tons (including particulates, sulphur dioxide and nitrogen oxide). There are virtually no processing plants for residuals and solid waste from industry. Industrial waste is often disposed of inadequately, in the same way as municipal solid waste.

It is estimated that 60 per cent of forests are damaged in some way.

Waste water treatment facilities are urgently needed for Palanga, Klaipeda and Kaunas. Air pollution 'hot spots' are associated with individual plants, notably Mazeikiai (oil refinery), Akmenė (cement industry), Jonava (fertilizer industry) and Elektrenai (power plant). The pulp and paper industry is responsible for a 'hot spot' at Klaipeda.

In addressing some of these problems, the Bank has provided support to the development of the Baltic Sea Joint Comprehensive Programme.
Financial policies

At an early stage in its operations, the Bank developed a set of Financial Policies designed to enable it to manage the risks inherent in its mandate, while at the same time become profitable in the near-term. The Agreement and the Bank's detailed Financial Policies, as approved by the Board of Directors, together with subsequent guidelines, define its funding and investment policies and risk limits so that the Bank is able to maintain a high standing in the international financial community. As a natural function of the risks associated with activities in the countries of operations, the Bank's financial policies are conservative. They contributed to the Bank's obtaining a triple A rating and to the successful response to its first bond issue in September 1991.

Capitalization

The Bank is strongly capitalized with subscribed capital of approximately ECU 10 billion, of which ECU 3 billion is paid-in capital and ECU 7 billion is callable capital. The large share of paid-in capital and high proportion of callable capital from highly-rated member countries reinforce its strong capital base. OECD countries, the European Investment Bank and the European Economic Community hold almost 85 per cent of the capital. The total amount of loans, equity investments and guarantees that can be made is limited to total subscribed capital plus reserves and surpluses, resulting in a conservative gearing ratio of one to one. Equity investments are not allowed to exceed paid-in subscribed capital, general reserve and surpluses. Callable capital may be called but only in the unlikely event that it is necessary to meet the Bank's liabilities, including in particular those to bondholders and beneficiaries of guarantees. 'Headroom', or unused financing capacity, will be monitored to ensure a sound financial structure which will reflect both strength in income and prudent risk management. All members are required to pay their paid-in capital in five equal annual instalments which may be divided between cash and promissory notes. The Board of Directors has now approved a programme for the regular annual encashment of such promissory notes on a three year cycle. At year-end 1991, the first instalment of ECU 591 million had been received with ECU 516.6 million in cash and only ECU 74.4 million remaining in unencashed promissory notes.

Borrowing programme

In 1991, the Bank's borrowing strategy focused on establishing the Bank's name in the international capital markets and on achieving a low overall cost of funds, while diversifying funding sources. The Bank set a borrowing plan of ECU 800 million for 1991 and 1992. Its first public issue of ECU 500 million was priced at the level of the most actively traded benchmark of the same maturity and was placed across a range of investors worldwide. After swapping the proceeds into floating rate US dollars, ECU and Deutsche marks, the Bank was able to reinvest the proceeds at a substantial positive margin. Within the overall borrowing plan, the Bank was further authorized to borrow up to ECU 200 million through the first quarter of 1992 in several funding operations. It will continue to take advantage of funding opportunities in an effort to diversify further its borrowing source while generating a low all-in-cost of funds and thereby derive a carrying gain from the proceeds of issues pending disbursements.
**Investment of liquid assets**

The Bank’s liquid asset portfolio comprises funds from paid-in capital and borrowings. It will also eventually include repayments from Bank loans and accumulated earnings. Liquid assets are targeted to be maintained at a minimum of 45 per cent of the Bank’s projected net cash requirements over the next three years. Investment policy objectives are to earn a reasonable return on the Bank’s capital and borrowed funds, while limiting interest rate risk. Specific investment authority and guidelines, approved by the Board of Directors, set parameters for managing liquid assets and strictly limiting credit and financial risk. The average duration of the portfolio is limited to four years.

**Lending and equity investments**

To minimize risks on the Bank’s lending portfolio, to the extent possible, the Bank’s assets will match liabilities in terms of currencies, maturities and interest rates: loans will be funded in the same currency. Equity investments, usually in the form of common or preferred shares, however, will be denominated largely in non-convertible currencies. The amount of equity investments will not exceed paid-in subscribed capital, general reserves and surpluses. Asset pricing is flexible with loans available at fixed and floating rates in major convertible currencies. The interest rate charged will be a margin over market rates, usually LIBOR. Loan margins will be differentiated primarily according to credit risk, taking also into account market terms offered by other lenders for similar loans. Fees and commissions will also be charged. All loans and equity investments will be subject to a thorough appraisal and credit evaluation process and will be continually monitored. In addition, specific guidelines were issued to limit risk to the Bank’s lending and equity investment portfolio by limiting the Bank’s exposure to any one country, industry sector, borrower or project.

In 1991, the Bank’s Board approved 10 loans, totalling ECU 363.9 million, one line of credit of ECU 29.8 million and three equity investments totalling ECU 33.8 million.

**Provisions and reserves**

The Agreement requires provisions and reserves to be made against possible losses. Overall targets for the total of special and general reserves, together with general loan and equity loss provisions have been set initially at 10 per cent of disbursed loans plus 25 per cent of disbursed equity investments. The special reserve has been established with amounts derived from fees and commissions. The Agreement also requires the Bank to transfer all retained earnings to the general reserve. The general reserve must represent 10 per cent of authorized capital before the Bank may allocate such funds for other purposes. By year-end 1991, ECU 62,000 had been allocated to the special reserve. There were no allocations for loan and equity loss provisions.

**Loan disbursements and repayments**

Most loans will be medium to long-term with a normal maximum maturity limit of 15 years for government-guaranteed loans and 10 years for competitive enterprise sector loans. Principal repayments should commence as soon as a positive cash flow from the project is available; grace periods will be permitted in certain instances. Repayments will be structured according to the requirements of the project and in accordance with the Bank’s risk management policies. Financial policy guidelines also define the treatment of potentially delinquent loans.
Cooperation funds

Technical Cooperation Funds Programme

The Bank has a special mandate to support its countries of operations in their economic transition with technical assistance, training and advisory services. The provision of such assistance is an important function complementing the Bank's transfer of loan and equity capital for public and private sector investments.

At this early stage in their economic transitions, the countries of central and eastern Europe urgently need the Bank's help, but are unable to pay for it in hard currency. To reconcile this situation, the Bank decided to mobilize grant funding from outside sources, as its own capitalization does not provide for non-reimbursable financing. In 1991, through its Cooperation Funds Programme (CFP), the Bank raised ECU 68 million in grant funds from bilateral and multilateral donors. Additional contributions to the CFP, both to replenish existing funds and establish new ones, are currently being negotiated. Of these funds, some 20 per cent are untied, approximately 60 per cent are partially tied (mainly to EU member countries and to the Bank's countries of operations) and the remaining 20 per cent are tied to donor countries.

In 1991, total commitments from the CFP amounted to ECU 9.5 million, and were allocated as follows:
• 27 per cent for environment related operations,
• 26 per cent for the financial sector,
• 18 per cent for advice in the field of privatization,
• 12 per cent for telecommunications studies,
• 9 per cent for transportation studies,
• 5 per cent for studies related to food distribution, and
• 3 per cent for legal advice.

Co-financing

In the course of its operations, the Bank will work closely with multilateral institutions and other interested sources of financing, both public and private.

It was in this spirit of cooperation, that the Bank's first approved lending operation, a US$ 50 million (ECU 37.29 million) equivalent loan to Poland for a heat supply restructuring and conservation project, was co-financed with the World Bank, which will provide US$ 20 million (ECU 14.92 million).
Financial statements

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# Balance sheet

At 31 December 1991

<table>
<thead>
<tr>
<th>Assets</th>
<th>Notes</th>
<th>31 December 1991 ECU 000</th>
</tr>
</thead>
<tbody>
<tr>
<td>Placements with and advances to banks</td>
<td>3</td>
<td>570,014</td>
</tr>
<tr>
<td>Other money market placements and advances</td>
<td>4</td>
<td>216,726</td>
</tr>
<tr>
<td>Investment securities</td>
<td>5</td>
<td>244,706</td>
</tr>
<tr>
<td>Interest receivable</td>
<td>6</td>
<td>15,597</td>
</tr>
<tr>
<td>Other assets</td>
<td>7</td>
<td>4,852</td>
</tr>
<tr>
<td>Promissory notes issued by member countries</td>
<td>8</td>
<td>74,433</td>
</tr>
<tr>
<td>Tangible assets</td>
<td></td>
<td>2,476</td>
</tr>
<tr>
<td><strong>Total assets</strong></td>
<td></td>
<td><strong>1,128,804</strong></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Liabilities</th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Borrowed funds</td>
<td>9</td>
<td>8,567</td>
</tr>
<tr>
<td>Interest payable</td>
<td></td>
<td>10,059</td>
</tr>
<tr>
<td>Other liabilities</td>
<td>10</td>
<td>26,321</td>
</tr>
<tr>
<td>Medium and long term borrowings</td>
<td>12</td>
<td>499,188</td>
</tr>
<tr>
<td><strong>Total liabilities</strong></td>
<td></td>
<td><strong>544,135</strong></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Capital</th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Subscribed</td>
<td>11</td>
<td>9,853,780</td>
</tr>
<tr>
<td>Callable</td>
<td></td>
<td>(6,897,625)</td>
</tr>
<tr>
<td>Paid-in capital</td>
<td></td>
<td>2,956,125</td>
</tr>
<tr>
<td>Instalments not yet received</td>
<td></td>
<td>(2,264,000)</td>
</tr>
<tr>
<td>Instalments due and received</td>
<td></td>
<td>591,225</td>
</tr>
<tr>
<td>Conversion reserve</td>
<td>13</td>
<td>(525)</td>
</tr>
<tr>
<td>General reserve</td>
<td>14</td>
<td>(6,093)</td>
</tr>
<tr>
<td>Special reserve</td>
<td>15</td>
<td>62</td>
</tr>
<tr>
<td><strong>Members’ equity</strong></td>
<td></td>
<td><strong>584,669</strong></td>
</tr>
</tbody>
</table>

| Total liabilities and members’ equity |       | **1,128,804**            |

Details of all balance sheet items are disclosed in note 20.
## Profit and loss account

For the period 15 April 1991 to 31 December 1991

<table>
<thead>
<tr>
<th></th>
<th>Period to 31 December 1991</th>
<th>ECU 000</th>
</tr>
</thead>
<tbody>
<tr>
<td>Interest income</td>
<td></td>
<td>39,260</td>
</tr>
<tr>
<td>Interest expense</td>
<td></td>
<td>(10,417)</td>
</tr>
<tr>
<td><strong>Net interest income</strong></td>
<td></td>
<td>28,843</td>
</tr>
<tr>
<td>Fee and commission income</td>
<td></td>
<td>88</td>
</tr>
<tr>
<td>Fee and commission expense</td>
<td></td>
<td>(83)</td>
</tr>
<tr>
<td>Other operating income</td>
<td></td>
<td>478</td>
</tr>
<tr>
<td><strong>Net income from financial operations</strong></td>
<td></td>
<td>29,346</td>
</tr>
<tr>
<td>General administrative expenses</td>
<td>16</td>
<td>(43,084)</td>
</tr>
<tr>
<td>Exceptional exchange gains</td>
<td>17</td>
<td>6,686</td>
</tr>
<tr>
<td><strong>Operating loss</strong></td>
<td></td>
<td>(7,052)</td>
</tr>
<tr>
<td>Transfer to special reserve</td>
<td>15</td>
<td>(62)</td>
</tr>
<tr>
<td><strong>Retained loss transferred to general reserve</strong></td>
<td>14</td>
<td>(7,114)</td>
</tr>
</tbody>
</table>
Statement of cash flows

For the period 15 April 1991 to 31 December 1991

<table>
<thead>
<tr>
<th>Banking activities</th>
<th>Notes</th>
<th>Period to 31 December 1991</th>
</tr>
</thead>
<tbody>
<tr>
<td>Operating loss</td>
<td></td>
<td>(7,052)</td>
</tr>
<tr>
<td>Adjustments to operating loss to determine</td>
<td></td>
<td></td>
</tr>
<tr>
<td>net cash provided by banking activities:</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Internal taxation</td>
<td>14</td>
<td>1,021</td>
</tr>
<tr>
<td>Interest receivable and other assets</td>
<td></td>
<td>(20,449)</td>
</tr>
<tr>
<td>Interest payable and other liabilities</td>
<td></td>
<td>36,380</td>
</tr>
<tr>
<td>Depreciation and amortization</td>
<td>8</td>
<td>9,104</td>
</tr>
<tr>
<td>Amortized discount on bond issue</td>
<td>12</td>
<td>38</td>
</tr>
<tr>
<td><strong>Net cash provided by banking activities</strong></td>
<td></td>
<td>19,042</td>
</tr>
</tbody>
</table>

| Banking operations                                     |       |                             |
| Placements with and advances to banks                 |       | (570,014)                   |
| Other money market placements and advances            |       | (216,726)                   |
| Borrowed funds                                         |       | 8,567                       |
| **Net cash used in banking operations**               |       | (778,173)                   |

| **Net cash used in banking activities and operations**|       | (759,131)                   |

| Investing activities                                   |       |                             |
| Net purchases of investment securities                 |       | (244,706)                   |
| Purchase of tangible assets                            | 8     | (11,580)                    |
| **Net cash used in investing activities**              |       | (256,286)                   |

| Net cash used before financing                         |       | (1,015,417)                 |

| Financing activities                                   |       |                             |
| Capital subscriptions*                                 |       | 516,267                     |
| Issue of long term bonds                               | 12    | 499,150                     |
| **Cash provided by financing activities**              |       | 1,015,417                   |

* Capital subscriptions comprise:
  - Paid-in capital received (page 128) 591,225
  - Promissory notes issued by member countries (note 7) (74,433)
  - Conversion reserve (note 13) (525)
  - 516,267
Loans and equity investments

At 31 December 1991

### Summary of loans approved

<table>
<thead>
<tr>
<th>Project/Borrower</th>
<th>Country</th>
<th>Approved by the Board of Directors ECU 000</th>
<th>Approved documentation signed ECU 000</th>
</tr>
</thead>
<tbody>
<tr>
<td>Hungarian Telecom</td>
<td>Hungary</td>
<td>90,885</td>
<td>4,913</td>
</tr>
<tr>
<td>Petofi Nyomda Rt</td>
<td>Hungary</td>
<td>4,913</td>
<td></td>
</tr>
<tr>
<td>IBG Food Processing</td>
<td>Poland</td>
<td>5,257</td>
<td>1,641</td>
</tr>
<tr>
<td>Lodom</td>
<td>Poland</td>
<td>44,745</td>
<td></td>
</tr>
<tr>
<td>Polska Telefonia Komórekowa</td>
<td>Poland</td>
<td>37,288</td>
<td>37,288</td>
</tr>
<tr>
<td>WBK Poznań</td>
<td>Poland</td>
<td>23,000</td>
<td></td>
</tr>
<tr>
<td>GEC Alshom-1MGB</td>
<td>Romania</td>
<td>142,000</td>
<td></td>
</tr>
<tr>
<td>Rom Telecom</td>
<td>Romania</td>
<td>4,847</td>
<td></td>
</tr>
<tr>
<td>Enhanced Digital Network</td>
<td>USSR</td>
<td>9,282</td>
<td></td>
</tr>
<tr>
<td>Parker Drilling Co</td>
<td>USSR</td>
<td>29,830</td>
<td></td>
</tr>
<tr>
<td>NMB/EBRD Central Europe Agency Line (line of credit only)</td>
<td>Central Europe</td>
<td>29,830</td>
<td>29,830</td>
</tr>
</tbody>
</table>

**Total loans approved**

<table>
<thead>
<tr>
<th></th>
<th>ECU 000</th>
<th>ECU 000</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>393,688</td>
<td>72,031</td>
</tr>
</tbody>
</table>

### Summary of equity investments approved

<table>
<thead>
<tr>
<th>Project/Investment</th>
<th>Country</th>
<th>Approved by the Board of Directors ECU 000</th>
</tr>
</thead>
<tbody>
<tr>
<td>Czechoslovakia Investment Corporation</td>
<td>CSFR</td>
<td>7,458</td>
</tr>
<tr>
<td>Čokoládovny</td>
<td>CSFR</td>
<td>24,096</td>
</tr>
<tr>
<td>Microsystem Rt</td>
<td>Hungary</td>
<td>2,237</td>
</tr>
</tbody>
</table>

**Total investments approved**

<table>
<thead>
<tr>
<th></th>
<th>ECU 000</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>33,781</td>
</tr>
</tbody>
</table>

* No disbursements had been made on the loans approved as at 31 December 1991.

** The documentation for the investments approved had not yet been signed at 31 December 1991.
Statement of capital subscriptions

At 31 December 1991

<table>
<thead>
<tr>
<th>Members of the European Communities</th>
<th>Shares</th>
<th>Total ECU 000</th>
<th>Callable ECU 000</th>
<th>Paid-in capital instalments not yet received ECU 000</th>
<th>Paid-in capital instalments due and received ECU 000</th>
</tr>
</thead>
<tbody>
<tr>
<td>Belgium</td>
<td>22,800</td>
<td>228,000</td>
<td>159,600</td>
<td>54,720</td>
<td>13,680</td>
</tr>
<tr>
<td>Denmark</td>
<td>12,000</td>
<td>120,000</td>
<td>84,000</td>
<td>28,800</td>
<td>7,200</td>
</tr>
<tr>
<td>France</td>
<td>86,175</td>
<td>851,750</td>
<td>596,225</td>
<td>204,420</td>
<td>51,105</td>
</tr>
<tr>
<td>Germany</td>
<td>85,175</td>
<td>851,750</td>
<td>596,225</td>
<td>204,420</td>
<td>51,105</td>
</tr>
<tr>
<td>Greece</td>
<td>6,500</td>
<td>65,000</td>
<td>45,500</td>
<td>15,600</td>
<td>3,900</td>
</tr>
<tr>
<td>Ireland</td>
<td>3,000</td>
<td>30,000</td>
<td>21,000</td>
<td>7,200</td>
<td>1,800</td>
</tr>
<tr>
<td>Italy</td>
<td>85,175</td>
<td>851,750</td>
<td>596,225</td>
<td>204,420</td>
<td>51,105</td>
</tr>
<tr>
<td>Luxembourg</td>
<td>2,000</td>
<td>20,000</td>
<td>14,000</td>
<td>4,600</td>
<td>1,200</td>
</tr>
<tr>
<td>Netherlands</td>
<td>24,800</td>
<td>248,000</td>
<td>173,600</td>
<td>59,520</td>
<td>14,880</td>
</tr>
<tr>
<td>Portugal</td>
<td>4,200</td>
<td>42,000</td>
<td>29,400</td>
<td>10,080</td>
<td>2,520</td>
</tr>
<tr>
<td>Spain</td>
<td>34,000</td>
<td>340,000</td>
<td>238,000</td>
<td>81,600</td>
<td>20,400</td>
</tr>
<tr>
<td>United Kingdom</td>
<td>85,175</td>
<td>851,750</td>
<td>596,225</td>
<td>204,420</td>
<td>51,105</td>
</tr>
<tr>
<td>European Economic Community</td>
<td>30,000</td>
<td>300,000</td>
<td>210,000</td>
<td>72,000</td>
<td>18,000</td>
</tr>
<tr>
<td>European Investment Bank</td>
<td>30,000</td>
<td>300,000</td>
<td>210,000</td>
<td>72,000</td>
<td>18,000</td>
</tr>
<tr>
<td><strong>Total Other European Countries</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Austria</td>
<td>22,800</td>
<td>228,000</td>
<td>159,600</td>
<td>54,720</td>
<td>13,680</td>
</tr>
<tr>
<td>Cyprus</td>
<td>1,000</td>
<td>10,000</td>
<td>7,000</td>
<td>2,400</td>
<td>600</td>
</tr>
<tr>
<td>Finland</td>
<td>12,500</td>
<td>125,000</td>
<td>87,500</td>
<td>30,000</td>
<td>7,500</td>
</tr>
<tr>
<td>Iceland</td>
<td>1,000</td>
<td>10,000</td>
<td>7,000</td>
<td>2,400</td>
<td>600</td>
</tr>
<tr>
<td>Israel</td>
<td>6,500</td>
<td>65,000</td>
<td>45,500</td>
<td>15,600</td>
<td>3,900</td>
</tr>
<tr>
<td>Liechtenstein</td>
<td>200</td>
<td>2,000</td>
<td>1,400</td>
<td>480</td>
<td>120</td>
</tr>
<tr>
<td>Malta</td>
<td>100</td>
<td>1,000</td>
<td>700</td>
<td>240</td>
<td>60</td>
</tr>
<tr>
<td>Norway</td>
<td>12,500</td>
<td>125,000</td>
<td>87,500</td>
<td>30,000</td>
<td>7,500</td>
</tr>
<tr>
<td>Sweden</td>
<td>22,800</td>
<td>228,000</td>
<td>159,600</td>
<td>54,720</td>
<td>13,680</td>
</tr>
<tr>
<td>Switzerland</td>
<td>22,800</td>
<td>228,000</td>
<td>159,600</td>
<td>54,720</td>
<td>13,680</td>
</tr>
<tr>
<td>Turkey</td>
<td>11,500</td>
<td>115,000</td>
<td>80,500</td>
<td>27,600</td>
<td>6,900</td>
</tr>
<tr>
<td><strong>Recipient Countries</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Albania</td>
<td>1,000</td>
<td>10,000</td>
<td>7,000</td>
<td>2,400</td>
<td>600</td>
</tr>
<tr>
<td>Bulgaria</td>
<td>7,900</td>
<td>79,000</td>
<td>55,300</td>
<td>18,960</td>
<td>4,740</td>
</tr>
<tr>
<td>CSFR</td>
<td>12,800</td>
<td>128,000</td>
<td>89,600</td>
<td>30,720</td>
<td>7,680</td>
</tr>
<tr>
<td>Hungary</td>
<td>7,900</td>
<td>79,000</td>
<td>55,300</td>
<td>18,960</td>
<td>4,740</td>
</tr>
<tr>
<td>Poland</td>
<td>10,600</td>
<td>106,000</td>
<td>66,600</td>
<td>30,720</td>
<td>7,680</td>
</tr>
<tr>
<td>Romania</td>
<td>4,800</td>
<td>48,000</td>
<td>33,600</td>
<td>11,520</td>
<td>2,880</td>
</tr>
<tr>
<td>USSR (note 11)</td>
<td>60,000</td>
<td>600,000</td>
<td>420,000</td>
<td>144,000</td>
<td>36,000</td>
</tr>
<tr>
<td>Yugoslavia</td>
<td>12,800</td>
<td>128,000</td>
<td>89,600</td>
<td>30,720</td>
<td>7,680</td>
</tr>
<tr>
<td><strong>Non-European Countries</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Australia</td>
<td>10,000</td>
<td>100,000</td>
<td>70,000</td>
<td>24,000</td>
<td>6,000</td>
</tr>
<tr>
<td>Canada</td>
<td>34,000</td>
<td>340,000</td>
<td>238,000</td>
<td>81,600</td>
<td>20,400</td>
</tr>
<tr>
<td>Egypt</td>
<td>1,000</td>
<td>10,000</td>
<td>7,000</td>
<td>2,400</td>
<td>600</td>
</tr>
<tr>
<td>Japan</td>
<td>85,175</td>
<td>851,750</td>
<td>596,225</td>
<td>204,420</td>
<td>51,105</td>
</tr>
<tr>
<td>Korea, Republic of</td>
<td>6,500</td>
<td>65,000</td>
<td>45,500</td>
<td>15,600</td>
<td>3,900</td>
</tr>
<tr>
<td>Mexico</td>
<td>3,000</td>
<td>30,000</td>
<td>21,000</td>
<td>7,200</td>
<td>1,800</td>
</tr>
<tr>
<td>Morocco</td>
<td>5,000</td>
<td>50,000</td>
<td>7,000</td>
<td>2,400</td>
<td>600</td>
</tr>
<tr>
<td>New Zealand</td>
<td>1,000</td>
<td>10,000</td>
<td>7,000</td>
<td>2,400</td>
<td>600</td>
</tr>
<tr>
<td>United States of America</td>
<td>100,000</td>
<td>1,000,000</td>
<td>700,000</td>
<td>240,000</td>
<td>60,000</td>
</tr>
<tr>
<td><strong>Subscriptions by members</strong></td>
<td>985,375</td>
<td>9,853,750</td>
<td>6,897,625</td>
<td>2,364,900</td>
<td>591,225</td>
</tr>
<tr>
<td>Non-allocated shares</td>
<td>14,625</td>
<td>146,250</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Authorized share capital</td>
<td>1,000,000</td>
<td>10,000,000</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
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 organization formed under the Agreement Establishing the Bank dated 29 May, 1990 (the ‘Agreement’). Forty countries, together with the European Economic Community and the European Investment Bank, are the Bank’s shareholders.

ii Headquarters Agreement
The status, privileges and immunities in the United Kingdom of the Bank and persons connected therewith, are defined in the Headquarters Agreement between the Government of the United Kingdom of Great Britain and Northern Ireland and the Bank (the ‘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 under the historical cost convention modified by the inclusion of the revaluation of certain financial instruments and investment securities, in accordance with the Bank’s Accounting Policies, which comply with International Accounting Standards and the overall principles of the European Communities Council Directive on the Annual Accounts and Consolidated Accounts of Banks and Other Financial Institutions.

ii Presentation
In accordance with Article 4 of the Agreement, the Bank uses the European Currency Unit (ECU) as the unit of measure for the capital subscriptions of members and for the presentation of its financial statements. Where applicable, the following 31 December 1991 ECU exchange rates were used in the preparation of the financial statements:

<table>
<thead>
<tr>
<th>Currency</th>
<th>Exchange Rate</th>
</tr>
</thead>
<tbody>
<tr>
<td>United States dollars</td>
<td>1.34093</td>
</tr>
<tr>
<td>Deutsche marks</td>
<td>2.03553</td>
</tr>
<tr>
<td>Japanese yen</td>
<td>167.549</td>
</tr>
<tr>
<td>Pounds sterling</td>
<td>0.71012</td>
</tr>
<tr>
<td>French francs</td>
<td>0.95336</td>
</tr>
</tbody>
</table>

iii Foreign currencies
Assets and liabilities in currencies other than ECU are translated into ECU at market rates ruling at the year end, except where they are hedged when the hedged rate is used. It is the Bank’s policy not to hold positions in currencies other than ECU, except for minor cash balances arising in the ordinary course of business. Transactions in currencies other than ECU are translated into ECU at month end exchange rates. Exchange gains or losses arising from the translation of assets and liabilities and transactions during the year are taken to the profit and loss account.

iv Conversion reserve
Under the Agreement, capital subscriptions by members shall be settled either in ECU, in United States dollars or Japanese yen in the form of either cash or promissory notes. Capital subscriptions in United States dollars or Japanese yen are settled at fixed rates of exchange as defined in Article 6.3 of the Agreement. The defined fixed rates of exchange to the ECU are 1.16701 United States dollars and 169.95 Japanese yen.
Exchange differences arising between the fixed rate and the rate on either the date of receipt of cash or encashment of promissory notes are taken to conversion reserve.
Capital subscriptions received in the form of promissory notes denominated in currencies other than ECU and which are outstanding at year end are revalued as detailed in note (iii) above, with any exchange gains or losses being taken to the conversion reserve. The Board of Directors has authorized a policy for the hedging of future instalments of capital not yet received. Any premiums or discounts arising from such capital hedging transactions are taken to the conversion reserve.

129 European Bank for Reconstruction and Development
2 Significant accounting policies continued

v Financial instruments
Profits and losses arising from interest rate swaps and forward exchange agreements entered into for hedging purposes are matched against the item being hedged.

vi Fees and commissions
Loan origination fees are taken to income to the extent that they offset direct origination costs, in the period in which the costs are incurred. The residual balance of fees is amortized over the period of the loan. Other fees and commissions are taken to income over the period during which the commitment exists or services are provided.

vii Investment securities
Bonds, notes, bank certificates of deposit and other dated marketable securities held for investment are stated at adjusted cost by amortizing over the period to maturity the premium or discount arising upon acquisition.

viii Issuance fees and redemption premiums or discounts
Issuance fees and redemption premiums or discounts are amortized over the period to maturity of the related borrowings.

ix Tangible assets
Tangible assets are stated at cost less accumulated depreciation.
Depreciation of tangible assets is provided on a straight line basis over their estimated useful lives generally as follows:

<table>
<thead>
<tr>
<th>Asset Class</th>
<th>Depreciation Period</th>
</tr>
</thead>
<tbody>
<tr>
<td>Leases of less than 50 years unexpired</td>
<td>Unexpired periods or 15 years if shorter</td>
</tr>
<tr>
<td>Plant and equipment</td>
<td>3 to 5 years</td>
</tr>
</tbody>
</table>

x Staff retirement plan
The Bank has a defined contribution scheme and a defined benefit scheme to provide retirement plans for its staff. Actual contributions made to the defined contribution scheme are charged to the profit and loss account. Contributions made to the defined benefit scheme and the charge to the profit and loss account are based upon advice from qualified external actuaries.

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

xii Government grants
Government grants relating to fixed asset expenditure are recognised in the profit and loss account on a straight line basis over the same period as that applied for depreciation purposes. Grants received or receivable in respect of contributions towards profit and loss account expenditure items are matched against the qualifying expenditure in the period in which it is incurred. The balance of grants received or receivable which have not been taken to the profit and loss account are carried in the balance sheet as deferred income.
3 Placements with and advances to banks

<table>
<thead>
<tr>
<th></th>
<th>Amount</th>
<th>Hedging instruments</th>
<th>Net currency placement</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Analysed by currency:</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>European currency units</td>
<td>283,469</td>
<td>271,689</td>
<td>565,148</td>
</tr>
<tr>
<td>United States dollars</td>
<td>227,473</td>
<td>(227,473)</td>
<td></td>
</tr>
<tr>
<td>Deutsche marks</td>
<td>44,216</td>
<td>(44,216)</td>
<td></td>
</tr>
<tr>
<td>Sterling pounds*</td>
<td>14,810</td>
<td>–</td>
<td>14,810</td>
</tr>
<tr>
<td>French francs</td>
<td>15</td>
<td>–</td>
<td>15</td>
</tr>
<tr>
<td>Japanese yen</td>
<td>41</td>
<td>–</td>
<td>41</td>
</tr>
<tr>
<td><strong>At 31 December 1991</strong></td>
<td>570,014</td>
<td>–</td>
<td>570,014</td>
</tr>
</tbody>
</table>

**Analysed by maturity:**
- Up to and including 1 month: 368,869
- Over 1 month and up to and including 3 months: 25,000
- Over 3 months and up to and including 1 year: 153,569
- Over 1 year and up to and including 5 years: 22,576

4 Other money market placements and advances

<table>
<thead>
<tr>
<th></th>
<th>Amount</th>
<th>Hedging instruments</th>
<th>Net currency placement</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Analysed by currency:</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>European currency units</td>
<td>133,687</td>
<td>83,039</td>
<td>216,726</td>
</tr>
<tr>
<td>United States dollars</td>
<td>76,879</td>
<td>(76,879)</td>
<td></td>
</tr>
<tr>
<td>Deutsche marks</td>
<td>6,160</td>
<td>(6,160)</td>
<td></td>
</tr>
<tr>
<td><strong>As at 31 December 1991</strong></td>
<td>216,726</td>
<td>–</td>
<td>216,726</td>
</tr>
</tbody>
</table>

**Analysed by maturity:**
- Up to and including 1 month: 216,726

5 Investment securities **

<table>
<thead>
<tr>
<th></th>
<th>Amount</th>
<th>Hedging instruments</th>
<th>Net currency placement</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Analysed by currency:</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>European currency units</td>
<td>119,251</td>
<td>125,455</td>
<td>244,706</td>
</tr>
<tr>
<td>Japanese yen</td>
<td>38,138</td>
<td>(38,138)</td>
<td></td>
</tr>
<tr>
<td>United States dollars</td>
<td>87,317</td>
<td>(87,317)</td>
<td></td>
</tr>
<tr>
<td><strong>At 31 December 1991</strong></td>
<td>244,706</td>
<td>–</td>
<td>244,706</td>
</tr>
</tbody>
</table>

**Analysed by maturity:**
- Up to and including 1 month: 42,076
- Over 1 month and up to and including 3 months: 9,990
- Over 3 months and up to and including 1 year: 104,627
- Over 1 year and up to and including 5 years: 88,013

244,706

---

* Placements in Sterling pounds are held to cover future expenditure in that currency

** Investment securities are stated net of unamortized discount. They have a nominal value of ECU 249,055,000 and a market value of ECU 250,292,000
5 Investment securities continued

Analysed by issuer:
Governments 16,144
Public bodies 40,482
Other borrowers 188,080

6 Other assets

Other assets comprise:
Prepayments 2,132
Fees receivable 25
Sundry debtors 2,695

7 Promissory notes issued by member countries

<table>
<thead>
<tr>
<th>Currency of issue</th>
<th>Total received</th>
<th>Exchange gain (loss)</th>
<th>Exchange gain (loss)</th>
<th>Amount drawn down</th>
<th>Amount outstanding</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>ECU 000</td>
<td>ECU 000</td>
<td>ECU 000</td>
<td>ECU 000</td>
<td>ECU 000</td>
</tr>
<tr>
<td>European currency units</td>
<td>74,894</td>
<td>-</td>
<td>-</td>
<td>41,452</td>
<td>33,442</td>
</tr>
<tr>
<td>United States dollars</td>
<td>59,420</td>
<td>266</td>
<td>(6,109)</td>
<td>12,586</td>
<td>40,991</td>
</tr>
<tr>
<td>Japanese yen</td>
<td>28,852</td>
<td>2,182</td>
<td>-</td>
<td>27,734</td>
<td>-</td>
</tr>
<tr>
<td>At 31 December 1991</td>
<td>159,166</td>
<td>2,448</td>
<td>(6,109)</td>
<td>81,772</td>
<td>74,433</td>
</tr>
</tbody>
</table>

Under the Agreement, payment of the paid-in capital is to be made in five equal annual instalments. The Agreement permits a member to pay up to 50% of each instalment in non-negotiable, non-interest bearing promissory notes or other obligations issued by such 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. The Board of Directors have adopted an encashment policy which provides for a fixed schedule of draw down of these promissory notes in three equal annual instalments.

Promissory notes which are 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 1991. Realised and unrealised exchange gains or losses which have arisen between these rates of exchange respectively and the fixed rate of exchange as defined in the Agreement, have been taken directly to conversion reserve (note 13).

8 Tangible assets

<table>
<thead>
<tr>
<th></th>
<th>Leasehold property</th>
<th>Plant and equipment</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cost</td>
<td>ECU 000</td>
<td>ECU 000</td>
<td>ECU 000</td>
</tr>
<tr>
<td>Additions</td>
<td>8,805</td>
<td>2,775</td>
<td>11,580</td>
</tr>
<tr>
<td>Cost at 31 December 1991</td>
<td>8,805</td>
<td>2,775</td>
<td>11,580</td>
</tr>
<tr>
<td>Accumulated depreciation and amortization*</td>
<td>(8,673)</td>
<td>(431)</td>
<td>(9,104)</td>
</tr>
<tr>
<td>Net book value at 31 December 1991</td>
<td>132</td>
<td>2,344</td>
<td>2,476</td>
</tr>
</tbody>
</table>

* The cost of fitting out the Bank’s temporary headquarters at 122 Leadenhall Street has been fully amortized at 31 December 1991. The net book value at 31 December 1991 of leasehold property represents the unamortized cost of fitting out offices overseas.
9 Borrowed funds

Borrowed funds represent short term borrowings incurred by the Bank and subsequently repaid by 10 January 1992.

10 Other liabilities

Other liabilities comprise:

<table>
<thead>
<tr>
<th>Other liabilities</th>
<th>31 December 1991</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>ECU 000</td>
</tr>
<tr>
<td>Accruals</td>
<td>6,985</td>
</tr>
<tr>
<td>Deferred income</td>
<td>16,216</td>
</tr>
<tr>
<td>sundry creditors</td>
<td>3,120</td>
</tr>
<tr>
<td></td>
<td>26,321</td>
</tr>
</tbody>
</table>

11 Authorized share capital

<table>
<thead>
<tr>
<th>Authorized share capital</th>
<th>31 December 1991</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Shares</td>
</tr>
<tr>
<td>Authorized share capital</td>
<td>1,000,000</td>
</tr>
<tr>
<td>Of which:</td>
<td></td>
</tr>
<tr>
<td>Subscriptions by members</td>
<td>985,375</td>
</tr>
<tr>
<td>Non-allocated shares</td>
<td>14,625</td>
</tr>
<tr>
<td></td>
<td>1,000,000</td>
</tr>
</tbody>
</table>

The Bank’s authorized share capital is ECU 10,000 million divided into 1 million shares, having a par value of ECU 10,000 each. The authorized share capital is divided into paid-in shares and callable shares. The initial total aggregate par value of paid-in shares is ECU 3,000 million, equal to 30% of the original authorized share capital of ECU 10,000 million and is payable in five equal annual instalments. Under the Agreement, callable shares can be called only as and when required by the Bank to meet its liabilities.

The amount of non-allocated shares was established in the Agreement as 125 shares. Shares totalling 15,500, which were originally allocated for subscription by the former German Democratic Republic, were added to non-allocated shares. Subsequently, 1,000 shares were allocated to Albania. The Board of Governors has approved the admittance to membership of Estonia, Latvia and Lithuania who will each subscribe for 1,000 shares. These new subscriptions will be taken from the non-allocated shares.

The Board of Directors in considering membership issues following the dissolution of the USSR, decided that when a member country is dissolved, its shareholding should be divided between the States which were part of its territory and which the Board of Governors of the Bank determines, for the purposes of the Agreement, to be the States upon which the membership devolves.

A statement of capital subscriptions showing the amount of capital subscribed and paid-in by each member, together with the amount of non-allocated shares, is set out on page 128.
12 Medium and long term borrowings

<table>
<thead>
<tr>
<th></th>
<th>31 December 1991</th>
</tr>
</thead>
<tbody>
<tr>
<td>ECU 000</td>
<td>ECU 000</td>
</tr>
<tr>
<td>Principal at nominal value</td>
<td>500,000</td>
</tr>
<tr>
<td>Discount at date of issue</td>
<td>(850)</td>
</tr>
<tr>
<td><strong>Less:</strong></td>
<td></td>
</tr>
<tr>
<td>Amortized during the period</td>
<td>38</td>
</tr>
<tr>
<td>Unamortized discount</td>
<td>(812)</td>
</tr>
<tr>
<td><strong>Balance at 31 December 1991</strong></td>
<td>499,188</td>
</tr>
</tbody>
</table>

The Bank issued ECU 500 million of bonds during October 1991 at a fixed interest rate of 8.875% for long term funding. The bonds are repayable in full in October 1996. The bonds, which constitute unsecured obligations of the Bank, have been recorded at their nominal value less unamortized discount as shown above.

The Bank has entered into interest rate swaps for the equivalent of the full issue of ECU 500 million, replacing the fixed rate payment obligation with floating rate obligations.

13 Conversion reserve

*The conversion reserve comprises:*

Realised exchange gain arising upon receipt of the cash element of the capital instalments received in 1991 including the net cost of hedging the future capital instalments to be received

<table>
<thead>
<tr>
<th></th>
<th>Period to 31 December 1991</th>
</tr>
</thead>
<tbody>
<tr>
<td>ECU 000</td>
<td></td>
</tr>
<tr>
<td></td>
<td>3,136</td>
</tr>
</tbody>
</table>

Realised net exchange gain arising at dates of draw downs of promissory notes issued by member countries (note 7)

|                      | 2,448                     |

Unrealised exchange loss arising from the revaluation of outstanding promissory notes issued by member countries (note 7)

|                      | (6,109)                   |

At 31 December 1991

|                      | (525)                     |

14 General reserve

*The general reserve comprises:*

Retained loss

|                      | (7,114)                   |

Internal taxation

|                      | 1,021                     |

At 31 December 1991

|                      | (6,093)                   |

In accordance with Article 53 of the Agreement, all Directors, Alternate Directors, officers and employees of the Bank are subject to an internal rate of 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. Internal taxation amounting to ECU 1,021,000, deducted from salaries and emoluments paid during the year, has been transferred to general reserve.
15 Special reserve

Transfer from profit and loss account

In accordance with the Agreement, a special reserve is maintained for meeting certain defined losses of the Bank. The special reserve is established by setting aside specified fees and commissions received by the Bank.

16 General administrative expenses

<table>
<thead>
<tr>
<th>Note</th>
<th>Actual ECU 000</th>
<th>Budget ECU 000</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Personnel costs</td>
<td>i</td>
<td>23,320</td>
</tr>
<tr>
<td>Overhead expenses net of government grants</td>
<td>ii</td>
<td>12,224</td>
</tr>
<tr>
<td>Preliminary expenses</td>
<td>iii</td>
<td>7,540</td>
</tr>
<tr>
<td>General administrative expenses</td>
<td></td>
<td>35,544</td>
</tr>
</tbody>
</table>

i The average number of staff and members of the Board of Directors included in personnel costs during the period was 286.

ii Government grants of ECU 13,560,000 (Budget: ECU 10,965,000), included in the period to 31 December 1991, have been provided by the governments of the United Kingdom (ECU 13,077,000), France (ECU 307,000) and Japan (ECU 176,000).

iii Preliminary expenses represent the audited costs incurred by the Bank prior to its commencement of operations on 15 April 1991. The Board of Governors approved a budget for these costs of ECU 10,000,000.

The budget of ECU 45,748,000 was that approved by the Board of Directors for the period to 31 December 1991.

17 Exceptional exchange gains

The Bank received part of the first paid-in capital cash instalments in currencies other than ECU. These currencies were later converted into ECU. The difference between the rates of exchange prevailing on the dates of receipt and the rates of exchange prevailing on the dates of conversion into ECU resulted in an exchange gain of ECU 6,686,000.

Future cash payments in currencies other than ECU of instalments of paid-in capital are to be converted into ECU immediately upon notification of receipt.
18 Technical assistance and cooperation funds

The Bank provides technical assistance for the preparation, financing and implementation of projects and to assist countries of operations in making the transition towards open market oriented economies. Funding for this technical assistance may come from the Bank’s ordinary capital resources, Special Fund resources as defined in the Agreement or cooperation funds. Cooperation funds are grants from donors provided for technical assistance activities administered by the Bank pursuant to agreements of cooperation concluded with such donors.

At 31 December 1991, the Bank administered eleven cooperation funds for an aggregate amount of approximately ECU 68 million which were financed wholly by third party donors. The assets of the cooperation funds are held separately from the assets of the Bank.

19 Staff retirement plan

The Bank operates a defined contribution scheme (money purchase retirement plan) together with a defined benefit scheme (final salary retirement plan) for its staff. The assets of the money purchase retirement plan are held separately from the assets of the Bank. The costs of the final salary retirement plan, included under accruals in note 10, have been assessed in accordance with an actuarial valuation as at 25 September 1991, using the individual entry age method.

The Bank’s contributions to the money purchase retirement plan together with the costs of the final salary retirement plan have been charged to the profit and loss account.

20 Off balance sheet items

At 31 December 1991 loan commitments amounted to ECU 72,031,000 as set out on page 127.

The Bank has entered into commitments under forward foreign exchange contracts, foreign exchange options, interest rate swaps and currency swaps in the normal course of business for hedging purposes. These are disclosed in notes 3, 4, 5, 12 and 13 and amount to the following:

<table>
<thead>
<tr>
<th>Contract or notional amount</th>
<th>ECU million</th>
</tr>
</thead>
<tbody>
<tr>
<td>Forward exchange contracts</td>
<td>181</td>
</tr>
<tr>
<td>Cross currency interest rate swaps</td>
<td>433</td>
</tr>
<tr>
<td>Interest rate swaps</td>
<td>353</td>
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<tr>
<td>Forward exchange options</td>
<td>102</td>
</tr>
</tbody>
</table>

At 31 December 1991

<table>
<thead>
<tr>
<th>Amount</th>
<th>1,069</th>
</tr>
</thead>
</table>
Auditors' report to The President and Board of Governors
European Bank for Reconstruction and Development

We have audited the financial statements on pages 124 to 130 in accordance with International Auditing Guidelines.

In our opinion the financial statements present fairly the financial position of the European Bank for Reconstruction and Development at 31 December 1991 and of its loss and cash flows for the period from 15 April 1991 to 31 December 1991 and comply with International Accounting Standards and the overall principles of the European Communities Council Directive on the Annual Accounts and Consolidated Accounts of Banks and Other Financial Institutions.

[Signature]

185, avenue Charles-de-Gaulle
92201 Neuilly-sur-Seine
Paris
25 February 1992
## Appendices

**Governors and Alternates**

As at 31 December 1991

<table>
<thead>
<tr>
<th>Member</th>
<th>Governor</th>
<th>Alternate Governor</th>
</tr>
</thead>
<tbody>
<tr>
<td>Albania</td>
<td>Gramoz Pashko</td>
<td>-</td>
</tr>
<tr>
<td>Australia</td>
<td>John Dawkins</td>
<td>Richard Woolcott</td>
</tr>
<tr>
<td>Austria</td>
<td>Ferdinand Lacina</td>
<td>Othmar Haushofer</td>
</tr>
<tr>
<td>Belgium</td>
<td>Philippe Maystadt</td>
<td>Grégoire Bruhns</td>
</tr>
<tr>
<td>Bulgaria</td>
<td>Ivan Yordanov Kostov</td>
<td>Mileti Mladenov</td>
</tr>
<tr>
<td>Canada</td>
<td>Donald Mazankowski</td>
<td>Reid Morden</td>
</tr>
<tr>
<td>Cyprus</td>
<td>George Syrini</td>
<td>Michael Erotokritos</td>
</tr>
<tr>
<td>CSFR</td>
<td>Vaclav Klaus</td>
<td>Josef Tokovsky</td>
</tr>
<tr>
<td>Denmark</td>
<td>Uffe Ellemann-Jensen</td>
<td>Ole Loensmann Poulsen</td>
</tr>
<tr>
<td>EEC</td>
<td>Henning Christophersen</td>
<td>Karel Van Miert</td>
</tr>
<tr>
<td>EIB</td>
<td>Ernst-Günther Bröder</td>
<td>Alain Prate</td>
</tr>
<tr>
<td>Egypt</td>
<td>Yousri Mostafa</td>
<td>Saud Al Farargi</td>
</tr>
<tr>
<td>Finland</td>
<td>Pertti Saloainen</td>
<td>Veikko Kantola</td>
</tr>
<tr>
<td>France</td>
<td>Pierre Bérégovoy</td>
<td>Jean-Claude Trichet</td>
</tr>
<tr>
<td>Germany</td>
<td>Theo Waigel</td>
<td>Horst Köhler</td>
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<tr>
<td>Greece</td>
<td>Efthymios Christodoulou</td>
<td>George Theophanous</td>
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<td>Mihaly Kupa</td>
<td>Imre Taras</td>
</tr>
<tr>
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<td>Jon Sigurdsson</td>
<td>Bjorn Frisvoldsson</td>
</tr>
<tr>
<td>Ireland</td>
<td>Bertie Ahern</td>
<td>Scan P Cromien</td>
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<tr>
<td>Israel</td>
<td>Jacob A Frenkel</td>
<td>Shalom Singer</td>
</tr>
<tr>
<td>Italy</td>
<td>Guido Carli</td>
<td>Mario Draghi</td>
</tr>
<tr>
<td>Japan</td>
<td>Tsutomu Hata</td>
<td>Yasushi Mieno</td>
</tr>
<tr>
<td>Republic of Korea</td>
<td>Yong-Man Rhee</td>
<td>Kun Kim</td>
</tr>
<tr>
<td>Liechtenstein</td>
<td>Egmond Frommelt</td>
<td>-</td>
</tr>
<tr>
<td>Luxembourg</td>
<td>Jacques Santer</td>
<td>Yves Mersch</td>
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<tr>
<td>Malta</td>
<td>George Bonello Du Puis</td>
<td>Anthony P Galdes</td>
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<td>Mexico</td>
<td>Pedro Aspe</td>
<td>José Angel Gurria</td>
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<tr>
<td>Morocco</td>
<td>Mohamed Berrada</td>
<td>Mohammed Dairi</td>
</tr>
<tr>
<td>Netherlands</td>
<td>Wim Kok</td>
<td>Hans van den Broek</td>
</tr>
<tr>
<td>New Zealand</td>
<td>Don McKinnon</td>
<td>George Gair</td>
</tr>
<tr>
<td>Norway</td>
<td>Sighjorn Johnsen</td>
<td>Jon Ivar Nilsund</td>
</tr>
<tr>
<td>Poland</td>
<td>Andrzej Topinski</td>
<td>Stefan Kawałeck</td>
</tr>
<tr>
<td>Portugal</td>
<td>acting Governor</td>
<td>acting Alternate Governor</td>
</tr>
<tr>
<td>Romania</td>
<td>Jorge Braga de Macedo</td>
<td>Jose Monteiro Fernandes Bras</td>
</tr>
<tr>
<td>Spain</td>
<td>Florian Bereza</td>
<td>Mugur Isarescu</td>
</tr>
<tr>
<td>Sweden</td>
<td>Carlos Solchaga</td>
<td>Pedro Perez</td>
</tr>
<tr>
<td>Switzerland</td>
<td>Anne Wibelle</td>
<td>Olle Wästberg</td>
</tr>
<tr>
<td>Turkey</td>
<td>Jean Pascal Delamuraz</td>
<td>Silvio Arioli</td>
</tr>
<tr>
<td>United Kingdom</td>
<td>Tansu Çiller</td>
<td>Tevfik Altinok</td>
</tr>
<tr>
<td>United States of America</td>
<td>Lynda Chalker</td>
<td>Timothy Lankester</td>
</tr>
<tr>
<td>USSR</td>
<td>Nicholas Brady</td>
<td>Robert Zoellick</td>
</tr>
<tr>
<td>Yugoslavia</td>
<td>Victor Gerashchenko</td>
<td>Vasylod Stinin</td>
</tr>
<tr>
<td></td>
<td>(vacant)</td>
<td>Slavolub Stanic</td>
</tr>
</tbody>
</table>

138 European Bank for Reconstruction and Development
Directors, Alternates and Constituencies

As at 31 December 1991

Directors

- William Curran
- Claes de Neergaard
- Tony Faint
- Tetsunia Fujikawa
- James Humphreys
- Ron Keller
- Heiner Luschin
- Giuseppe Maresca
- Alexander Maslov
- Donald McCutchan
- Patrick Mordaq
- Kari Nars
- Guy Noppen
- Branimir Pajkovic
- Tomás Partzek
- Jacques Reverdin
- Christopher Silson
- José da Silva Lopes
- Lars Tybjerg
- José Luis Ugarte
- Antoine Van Goethem
- Jan Winiecki
- Günter Winkelmann

Alternate Directors

- Emily Walker
- Halldór J Kristjánsson
- Craig Pickering
- Yoshihisa Kuroda
- Seung Woo Kwon
- Paul Menkveld
- Mordechai D Fraenkel
- Maurizio Serra
- Serguei Ossetichik
- Robert Mackenzie
- -
- Erik Aarhus
- Ernest Mahlen
- Stanel Ghencea
- György Motolcsy
- Ibrahim Berberogh
- Terry Brown
- Dimitri Koulouzianos
- Pol O'Dubhhr
- Vicente Fernández
- Peter Blackie
- Plamen Ilchev
- -

Constituencies

- USA
- Sweden/Iceland
- UK
- Japan
- Australia/Korea/Egypt/New Zealand
- Netherlands
- Austria/Israel/Cyprus/Malta
- Italy
- USSR
- Canada/Morocco
- France
- Finland/Norway
- Belgium/Luxembourg
- Yugoslavia/Romania
- CSFR/Hungary
- Switzerland/Turkey/Liechtenstein
- EIB
- Portugal/Greece
- Denmark/Ireland
- Spain/Mexico
- EEC
- Poland/Bulgaria
- Germany

Composition of Board of Directors’ Committees

As at 31 December 1991

Audit Committee

- Kari Nars Chairman
- Branimir Pajkovic Vice-Chairman
- Tony Faint
- Jacques Reverdin
- Donald McCutchan
- Tomás Partzek
- José da Silva Lopes
- Günter Winkelmann
- James Humphreys Chairman
- Ron Keller Vice-Chairman
- Tetsunia Fujikawa
- Heiner Luschin
- Christopher Silson
- Lars Tybjerg
- José Luis Ugarte
- Jan Winiecki

Committee on Staff Compensation and Administrative Affairs of the Board

Committee on Staff Compensation and Administrative Affairs of the Board

Finance Committee

- Antoine Van Goethem Chairman
- William Curran Vice-Chairman
- Claes de Neergaard
- Giuseppe Maresca
- Alexander Maslov
- Donald McCutchan
- Patrick Mordaq
- Guy Noppen

2. Tetsunia Fujikawa succeeded Shotaro Miyake (July 1991)
4. György Motolcsy succeeded Andras Horváth (October 1991)

199 European Bank for Reconstruction and Development
<table>
<thead>
<tr>
<th>Country</th>
<th>Capital Subscription ECU million</th>
<th>Percentage of Capital Stock</th>
<th>Country</th>
<th>Capital Subscription ECU million</th>
<th>Percentage of Capital Stock</th>
</tr>
</thead>
<tbody>
<tr>
<td>Australia</td>
<td>100.00</td>
<td>1.00</td>
<td>United Kingdom</td>
<td>851.75</td>
<td>8.52</td>
</tr>
<tr>
<td>Austria</td>
<td>228.00</td>
<td>2.28</td>
<td>USA</td>
<td>1000.00</td>
<td>10.00</td>
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<td>Belgium</td>
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<td>600.00</td>
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<td>79.00</td>
<td>0.79</td>
<td>Yugoslavia</td>
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<td>340.00</td>
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<td>EEC</td>
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<td>10.00</td>
<td>0.10</td>
<td>EIB</td>
<td>300.00</td>
<td>3.00</td>
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<tr>
<td>Czech and Slovak Federal Republic</td>
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<td></td>
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<tr>
<td>Denmark</td>
<td>120.00</td>
<td>1.20</td>
<td>Membership approved by Governors during 1991</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Egypt</td>
<td>10.00</td>
<td>0.10</td>
<td>Albania*</td>
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<tr>
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<tr>
<td>Greece</td>
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<td>0.65</td>
<td>Unallocated shares**</td>
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<td>Israel</td>
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<tr>
<td>Japan</td>
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<td>8.52</td>
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<tr>
<td>Mexico</td>
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<td>Morocco</td>
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<td>0.10</td>
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<tr>
<td>Norway</td>
<td>125.00</td>
<td>1.25</td>
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<tr>
<td>Poland</td>
<td>128.00</td>
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<tr>
<td>Portugal</td>
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<td>3.40</td>
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<td>Sweden</td>
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<tr>
<td>Switzerland</td>
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<td>Turkey</td>
<td>115.00</td>
<td>1.15</td>
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</table>

*Effective date of Albania’s membership, 18 December 1991
**Following completion of membership procedures by Estonia, Latvia and Lithuania in early 1992
Management structure

- V.P. Merchant Banking
  - Country Transaction Teams
  - Key Sector Transaction Teams
  - Functional Transaction Teams

- V.P. Development Banking
  - Central & Eastern Europe
  - USSR
  - Public Infrastructure Energy & Environment
  - Cooperation Funds
  - Training
  - Procurement

- V.P. Finance
  - Treasury
  - Controller
  - Analysis
  - Corporate Planning
  - & Budgeting
  - Information Technology
  - Internal Audit

- V.P. Personnel & Administration
  - Personnel
  - Administration

- V.P. Evaluation
  - Secretary General
  - General Counsel
  - Chief Economist
  - Political Unit
  - Communications

*Valid until 31 December 1991
Department being restructured to take account of membership changes

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<td>Guy de Selliers, Senior Banker</td>
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*Valid until 31 December 1991. Department being restructured to take account of membership changes.*
Development Banking

Vice President: Mario Sarcinelli
Adviser to the Vice President: Pascal Lorot

Central and Eastern European Department

Department Director: Magne Haga
Albania: Matthias von Bismarck-Osten, Senior Country Manager
Bulgaria: Stijn Allbregts, Senior Country Manager
CSFR: Aldo Patania, Senior Country Manager
Estonia, Latvia, Lithuania: George Krivicky, Senior Country Manager (acting)
Hungary: Rolf Westling, Senior Country Manager
Poland: George Krivicky, Senior Country Manager
Romania: Klaus Hoffarth, Senior Country Manager (acting)
Yugoslavia: Klaus Hoffarth, Senior Country Manager

USSR Department

Deputy Department Director: Motoo Kusakabe

Infrastructure, Energy & Environment Department

Department Director: Thierry Baudon
Energy: Mark Tomlinson, Senior Project Manager
Environment: Tim Murphy, Senior Environmental Specialist
Rural & Agro Industrial Infrastructure: Juan Miranda, Senior Project Manager
Social Infrastructure: Michel Gaspard, Senior Project Manager
Telecommunications: Friedrich Kraemer, Senior Project Manager
Transport: Clell Harral, Senior Project Manager
Urban and Municipal Development: Josué Tanaka, Senior Project Manager

Support Services

Head of Co-Financing Unit: Ulrich Kiormayr
Head of Procurement Unit: Bernard Gouveia
Head of Training Unit: Philippe-Emmanuel Dewilde

*Valid until 31 December 1991. Department being restructured to take account of membership changes.
Finance
Vice President: Anders Ljungh
Information Technology: Guy de Poerck
Controller: Christopher Holysak
Treasurer: René Karsenti
Corporate Planning and Budgeting: Pierre Pissaloux
Director, Financial Policies and Analysis: Boris Zenic
Head of Internal Audit: Tarek Rouchdy

Personnel and Administration
Vice President: Miklós Németh
Director of Personnel: Sam Goldenberg
Director of Administration: Renaud Lagey

Evaluation
Vice President: Manfred Abelein

Secretary General
Secretary General: Bart le Blanc
Deputy Secretary General: Sarah Papineau

General Counsel
General Counsel: Andre Newburg
Deputy General Counsel: John Taylor
Assistant General Counsel: Emmanuel Maurice
Senior Counsel: Liz Hunt

Chief Economist
Chief Economist: John Flemming
Senior Economist: Philippe Aghion

Political Unit
Head, Political Unit: Sylvia Jay
Political Counsellor: Andrei Bogrov

Communications
Chief Press Officer: Barbara Ann Clay
Chief Public Affairs Officer: James Rosenstein
Members of the advisory councils

Business Advisory Council

The Business Advisory Council comprises 25 eminent industrialists and financiers from the private sector. The purpose of the Council is to provide guidance to the Bank and to share experience in all relevant areas in which its members have expertise. The members of the Council are:

Avv Giovanni Agnelli  
President of Fiat S.p.A. in Turin, Italy
Mr Jean-Louis Beffa  
President of Saint-Gobain in Paris, France
Mr Hervé de Carnoy  
Advisor to the President of HR Finance and President of Parvaland Gérance, in Paris, France
Mr Michel David-Weill  
Managing Director of Lazard Frères in Paris, France
Mr Richard Debs  
Advisory Director of Morgan Stanley & Co Inc in New York, USA
Ing Giuseppe Garofaro  
Chairman of Montedison in Milan, Italy
Mr Pehr G Gyllenhammar  
Executive Chairman of AB Vodaf in Gothenburg, Sweden
Mr Jean-Yves Haberer  
President & Director General of Crédit Lyonnais in Paris, France
Mr Karl Kalane  
Chairman of the Supervisory Board of Montana AG in Vienna, Austria
Mr Yusuke Kashiyagi  
Chairman of The Bank of Tokyo in Tokyo, Japan
Dr Karlheinz Kaske  
President & Chief Executive Officer of Siemens AG in Munich, Germany
Mr Raymond Kirsch  
Chief Executive Officer & President of the Executive Committee of the Banque et Caisse d’Epargne de l’Etat in Luxembourg

Mr Yoh Kurosawa  
President of The Industrial Bank of Japan in Tokyo, Japan
Mr Fritz Leutwiler  
Chairman of BBC Brown Boveri Limited in Baden, Switzerland
Mr Andre Leysen  
President of Agfa Gevaert in Mortsel, Belgium
Mr Robert McNamara  
Washington DC, USA
Mr Helmut Maucher  
Chairman of the Board & Chief Executive Officer of Nestlé SA in Vevey, Switzerland
Mr Henry Owen  
Co-Chairman of the Bretton Woods Committee in Washington DC, USA
Mr Albert Reichmann  
President of Olympia & York Developments Limited in London, UK
Mr Edzard Reuter  
Chairman of Daimler-Benz AG in Stuttgart, Germany
Mr Antoine Riboud  
President & Director General of BSN in Paris, France
The Rt Hon Lord Richardson of Dunblane KG  
Former Governor of the Bank of England & Vice Chairman of the BIS
Mr Hans-Joerg Rudloff  
Chairman of Crédit Suisse First Boston in London, UK
Dr Heinz Schimmelbusch  
Chairman of Metallgesellschaft AG in Frankfurt, Germany
Mr Alain de Wulf  
Director General of Banque Paribas in Paris, France
Mr Takuma Yamamoto  
Chairman of Fujitsu in Tokyo, Japan
Economic Advisory Council

The Economic Advisory Council was established to provide a link between the Bank and the academic community, in particular in the area of research on the economics of transition. It also advises the Bank on the economic issues raised by its activities.

It comprises the following members:

Academician Abel G Aganbegyan
Rector at the Academy of National Economy of the USSR in Moscow, USSR
Professor Kenneth J Arrow
Professor of Economics at Stanford University in Stanford, California, USA
Professor Jean-Paul Fitoussi
President of the OFCE in Paris, France
Professor Ryutaro Komiyi
Director General of the Research Institute of International Trade & Industry in Tokyo, Japan
Professor János Kornai
Professor of Economics at the Institute of Economics in Budapest, Hungary
Professor Assar C Lindbeck
Professor of International Economics at the Institute for International Economics in Stockholm, Sweden
Professor Edmund S Phelps
Professor of Political Economy at Columbia University in New York, USA
Professor Robert M Solow
Professor of Economics at the Massachusetts Institute of Technology in Cambridge, USA
Professor Luigi Spaventa
Professor of Economics at the Universita degli Studi in Rome, Italy
Professor Dr C Christian von Weizsäcker
Professor of Economics at the University of Cologne in Cologne, Germany

Environmental Advisory Council

The Bank is directed in its Agreement to promote environmentally sound and sustainable development in the full range of its activities. The Environmental Advisory Council, a direct advisory body to the President, assists the Bank to meet this goal.

13 of the 17 Council members have now been appointed:

Dr Wojciech Behlo
Director of the Environment Department of Katowice Province, Poland
Mr Jacques-Yves Cousteau
Director, Fondation Cousteau, France
Dr Boguslaw Fiedor
Professor of Economics at the Oscar Lange Academy of Economics in Wroclaw, Poland and member of the European Association of Natural Resources and Environmental Economics
Dr Peter Hardi
Executive Director of the Regional Environmental Center in Budapest, Hungary
Dr Martin Holdgate
Director General of the International Union for the Conservation of Nature and Natural Resources, Switzerland
Dr Andréj Kassenberg
President of the Institute for Sustainable Development in Warsaw, Poland
Dr Václav Mezrický
Director of the Environmental Law Institute at Charles University, Prague, CSFR and former First Deputy Minister of Environment of the Czech Republic
Sir Crispin Tickell
President of the Royal Geographic Society, London, UK and Chairman of the International Institute for Environment and Development, UK
Mr Angheluta Vadineanu
Professor of Ecology, University of Bucharest and
Chairman of the Commission of Ecology of the
Romanian Academy
Mr Janos Vargha
President of ISTER Environmental Research Institute in
Budapest, Hungary and Board Member of the Danube
Circle, Hungary
Mr Delcho Georgiev Vitchev
Member of the Executive Council, ECOGLASNOST,
Bulgaria
Professor Dr E U von Weizäcker
Director of the Institute for European Environmental
Policy in Bonn, Germany
Mr Jan- Olaf Willums
Executive Director of the International Environment
Bureau, International Chamber of Commerce, Paris,
France

The remaining four members are being recruited and
will extend the institutional, technical and geographical
scope of the Council.
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List of abbreviations and acronyms
AFD Alliance of Free Democrats (Hungary)
BIS Bank for International Settlements
BTO Bukh, Operate, Transfer, (a form of concession financing where the private sector finances the building and operation of public facilities while the
government grants various types of 'concessions' which normally include grants of land, sometimes finance, as well as public license to do business. At the end of the concession the facility is transferred back to the
government.
BSF Bulgarian Socialist Party
BNB Bulgarian National Bank
CBS Commonwealth of Independent States
CMEA Council for Mutual Economic Assistance
CSFR Czech and Slovak Federal Republic
CSCE Conference on Security and Cooperation in Europe
COP Cooperation Funds Programme
DEL Direct exchange line
DP Democratic Party (Albania)
ECB Economic Cooperation for Europe (United Nations)
ECU European Currency Unit
EDN Enhanced Digital Network (Soviet company)
EGE/ED European Economic Community, European Communities
EIB European Investment Bank
ETF European Free Trade Association
GFS Government Finance Statistics
GMP Gross National Product
GDP Gross Domestic Product
HDF Hungarian Democratic Forum
HTC Hungarian Telecommunications Company
IBRD International Bank for Development and Reconstruction
IFC International Finance Corporation
IIF International Financial Institution
IMF International Monetary Fund
IMSS Intrapandirea de Masini Grele Bucuresti (Romanian heavy equipment manufacturer)
Ilarge Initial Technical Assistance Programme
ICU International Union for the Conservation of Nature and Natural Resources
JNA Yugoslav Federal Army
LIBOR London interbank offered rate
MID Regional Development Initiative
MIGA Multilateral Investment Guarantee Agency
NATO North Atlantic Treaty Organisation
NIB Nordic Investment Bank
NMP Netz Material Product
NSF National Salvation Front (Romania)
OECD Organisation for Economic Cooperation and Development
OMSISYS Observatoire Mondial des systemes de Communication
OTR National Savings Bank (Hungary)
PHARE Poland and Hungary: Aid for Economic Restructuring (ED)
PPT Post, telegraph and telephone organizations
POTS Plain, old telephone service
RTRem Telecom
SPA State Property Agency (Hungary)
SPF Slovak Posts and Telecom
UDF Union of Democratic Forces (Bulgaria)
UNDP United Nations Development Programme
WBU West European Union