Letter from the Board of Directors to the Board of Governors

To the Board of Governors:

The Board of Directors of the Black Sea Trade and Development Bank has reviewed and endorsed this Annual Report for the fiscal year ended December 31, 1999. The Annual Report for the first year of operations of the Bank was prepared in conformity with the Bank's documents. It was discussed at the Board of Directors and the Directors' recommendations were incorporated. The President of the Bank and Chairman of the Board of Directors submits this report accompanied by the audited financial statements.

The Directors are pleased to report that in fiscal year 1999 BSTDB hired a highly qualified core group of staff and that major policy documents and country strategies were prepared and approved by the Board of Directors. Therefore, all conditions were met for the Bank to commence operations. At the first Annual Meeting in Kyiv, in April 1999, the Board of Governors, pursuant to Article 62 of the Agreement Establishing the Bank, adapted Resolution No 6 authorising the Bank to commence operations on June 1st, 1999. Since then, a number of project and trade finance operations have been approved by the Board of Directors. The Bank ended fiscal year 1999 with a positive operating balance.

Ersoy Volkan
President Black Sea Trade and Development Bank
Chairman of the Board of Directors

Statement by the President of the BSTDB

The coming of age of the Black Sea Trade and Development Bank (BSTDB) marks not only an important event for the Black Sea Economic Cooperation Region (BSEC), but is also a significant achievement, particularly at a time when regional co-operation becomes increasingly the most efficient way to foster economic progress. Regional institutions providing finance for development, as a medium for the promotion of understanding and cooperation, are poised to play key roles in the global institutional framework in the new Millennium.

BSTDB represents one part of this framework and we define our mission as assisting our Member countries to achieve economic progress. In achieving our mission, one of our most important goals is to promote cooperation and trade among our Member countries, so as to bring additional and sustainable benefits to the entire Region. This policy line should help the Member States in their efforts to take advantage of synergies in their economic co-operation, thus contributing to greater prosperity.

The relevance of our vision is confirmed by the interest shown by the international financial community in the establishment and progress of the BSTDB. We understand this interest as an indication of their belief that our Bank is an efficient and secure instrument to channel development funds towards the Black Sea Region.

The philosophy expressed through the BSTDB has its roots in the realities of our Region. The Bank is not the only regional international financial institution created to promote trade and regional economic integration. Asia, Africa, Northern Europe and Latin America, have all developed similar investment concepts to ensure long-term development. Our distinctive feature is the focus on fostering economic development through trade and regional cooperation, in particular operations involving participants from at least two of our member countries. Relations with our member countries, which are both shareholders and project beneficiaries, are strong and permanent through the non-resident Directors who remain economic decision-makers in their respective countries. But the Bank has also developed ad-hoc contacts with BSEC and BSEC bodies such as the BSEC Business Council or the national Chambers of Industry and Commerce. Although there are no statutory restrictions to membership on the basis of geographic proximity to the Black Sea, countries that seek membership in BSTDB must be members of BSEC. However, membership to the BSTDB is open to other IFIs, a characteristic that allows the sharing of regional expertise. These are important features, which enable the Bank to devise tailor-made policies and strategies for the Member Countries.

The shareholders of BSTDB are strongly committed to the distinctive philosophy and the ambitious objectives of the Bank, and they are determined to work together to develop its operations. By making diligent use of our distinctive features, we aim to play the role of an effective catalyst in attracting flows of financial and technical resources into the Region.

During 1999, the BSTDB created the necessary foundations for its future growth. The Bank's Headquarters were relocated to new premises in a centrally located building in Thessaloniki. Top priority was assigned to filling our managerial and administrative ranks with qualified professionals, elaborating country and regional strategies, and starting up operations. The Bank successfully recruited a dynamic blend of banking professionals with international profiles and excellent regional backgrounds. This human resources structure makes the Bank a financial institution well placed to create business opportunities and identify and properly manage the risks involved in its operations.

The legal and policy framework of documents that govern the Bank's financial activities and lending operations were prepared and approved by the Board of Directors. BSTDB's operational strategy is designed to provide enough flexibility to enable it to respond adequately to changes in political, economic and market conditions. As a result, BSTDB has developed a two-year operational strategy which aims to establish the Bank as a quickly growing, commercially minded institution looking to achieve development impact and enhancement of cooperation in all of its operations, in compliance with internationally accepted sound banking principles.

In terms of sector by sector priorities, the Bank is concentrating on sectors, which are crucial for promotion and facilitation of co-operation and trade between the Member countries: in particular, energy, transportation, manufacturing and services, and telecommunications. While the Bank does not seek a predetermined percentage of private or public sector operations, development of the private sector in the Region is a key objective of operations.

Given the relatively high credit risk profile on the lending side, resulting largely from the Region of operations, the Bank aims to minimize its exposure to other risks. Hence, Treasury operations are performed within conservative risk parameters and within a comprehensive policy framework.

Altogether, these efforts in putting together the Bank's launch strategy culminated in BSTDB's official start of operations on June 1st, 1999.

Marketing efforts across the Member countries resulted in receipt of numerous financing proposals, as regards both trade finance and project finance. This pipeline of projects has been subjected to a comprehensive review process, to ensure that the operation fulfils the Bank's mandate, is financially viable, and generates additional economic and cooperation benefits.

These characteristics are evident in the Bank's first project, *the Trans-Balkan Gas Pipeline Project*, which was signed in Moscow in December 1999. The project is financially solid, and it improves key energy infrastructure that will facilitate additional economic activity. The project is beneficial for six Member countries- Bulgaria, Moldova, Romania, Russia, Turkey, and Ukraine and hence has a strong cross-country impact. As regards trade finance operations, during the course of

1999, our Board of Directors approved two financial intermediaries, Vneshtorgbank, the Russian Federation's Bank for Foreign Trade and Turk Eximbank, the Export Credit Bank of Turkey, to introduce short term trade finance products to the respective markets.

Our total portfolio of approved trade finance and project finance operations for 1999 reached US$ 35 million. This represents a start, which should pave the way for accelerated expansion in the period ahead.

The current phase of intense operational efforts represents a major challenge for the management and staff of the BSTDB. Our achievements in the first year of operations owe much to the professionalism and dedication of BSTDB's staff and to the firm support of our Board of Governors and Board of Directors, whom I thank wholeheartedly, for the positive input and encouragement they have provided at all times.

Ersoy Volkan
President
Black Sea Trade and Development Bank

1999: The first year of operations of the Bank

I.1 1999 Key Figures

Total Revenues *(USD, '000)*	8,898
General Administrative Expenses *(USD, '000)*	4,889
Net Income *(USD, '000)*	4,039
Paid up capital *(USD, '000)*	178,649
Total Equity (subscribed) *(USD, '000)*	1,372,510
Number of staff	39

Start of operations: June 1, 1999

I.2 Mission of the Bank

Article 1 of the Agreement Establishing the Black Sea Trade and Development Bank describes the central purpose of the Bank as contributing to the development of- and economic cooperation among- the Member States, by providing banking services for projects of the public and private sectors in the Member States, and promoting trade activities among the Member States.

This effectively gives the Bank a dual mandate -- on the one hand to promote development in the individual Member States, and on the other to enhance regional cooperation. Maximization of shareholder value for the Bank as a regional financial institution means fulfilment, to the extent possible, of both these elements in all of its operations.

The Bank is able to offer a wide range of banking products and services to its prospective clients. The Bank finances both private and public sector operations, considering each operation on the basis of its individual economic merits, how these promote the fulfilment of the mandate, and the extent to which the operation achieves developmental and integration benefits greater than the direct financial benefits of the operation.

All operations in which the Bank becomes involved are economically sound and either actively assists market development, or are market friendly. The Bank is complimentary to private sector activity, taking on the elements of political risk which may discourage private firms interested in investing or trading in countries where the economic situation and investment environment are perceived as uncertain or risky. In this way, it ensures that activities are incremental, or 'Additional', for the region, so that there is no direct competition with, or displacement of, private sector activity.

Mobilization of additional financial resources for the Black Sea Economic Cooperation region is another key element in the Bank's strategy. Single project financing limits oblige the Bank to mobilize financing from other sources- such as equity investors, international financial institutions, commercial banks, investment funds, etc. Generating resources inflows that are a multiple of the Bank's own involvement will be a key indicator of the institution's successful operation.

One of the most fundamental principles incorporated in the rules and regulations is that the Bank shall be guided by sound banking principles and by considerations of transparency and accountability in all its operations. Other important principles require that the Bank manage its credit risk by establishing and monitoring prudent risk criteria, properly assessing risk mitigants, diversifying the geographic and sectoral coverage of operations, and meeting international environmental policy standards in its operations.

I.3 Corporate Governance and Staff Management

The Black Sea Trade and Development Bank's governing constitution is the Agreement Establishing the Bank which provides that the Bank will have a Board of Governors, a Board of Directors, a President, one or more Vice Presidents and such other officers and staff, as may be necessary. In addition, the position of the Secretary General of the Bank was created at the inaugural meeting of the Board of Governors.

The composition of the Board of Governors and the Board of Directors is shown in ANNEX

Corporate Governance

The BSTDB is managed as stipulated in the Agreement and is committed to effective corporate governance with responsibilities and related controls throughout the Bank properly defined and delineated. Transparency and accountability are key principles and integral elements of the Bank's corporate governance framework. The corporate governance structure is further supported by a system of reporting, with information appropriately tailored for and disseminated to, each level of responsibility within the BSTDB to enable the system of checks and balances of the Bank's activities to function effectively and efficiently.

Board of Governors

Each Member State of the BSTDB is represented on the Board of Governors, which consists mainly of high-level government officials designated by their respective country, the majority coming from either the Central Banks or the Finance Ministries. They represent the Member States as shareholders of the Bank. All powers with respect to BSTDB are vested in the Board of Governors. With the exception of certain reserved powers, the Board of Governors has delegated their exercise to the Board of Directors, while retaining overall authority. At each Annual Meeting, the Board of Governors elects one of the Governors as Chairman and two other Governors as Vice Chairmen.

In accordance with the Agreement, The Board of Governors establishes general directives for the purpose of governing the Bank and decides on capital stock increases, determines the number of Directors, appoints the President of the Bank, approves the balance sheet and statement of profit and loss, admits new members, determines the conditions of their admission, decides the reserve and distribution of the net income and surplus of the Bank, and exercises any other special powers assigned to the Board of Governors, as per the Agreement.

H.E. Victor YUSHCHENKO, BSTDB Governor for Ukraine, held the office of Chairman of the Board of Governors with H.E. Decebal Trajan REMES, BSTDB Governor for Romania as Vice-Chairman, until the Annual Meeting in April 1999. In accordance with the system of annual rotation, he was succeeded by Mr. Decebal Trajan REMES, who held the office of Chairman of the Board of Governors since then with H.E. Victor YUSHCHENKO and Mr. Merab KAKULIA, BSTDB Governor for Georgia, as Vice-Chairmen.

Board of Directors

The Board of Directors, chaired by the President of the Bank, is responsible for the direction of the general operations of the Bank and for this purpose, in addition to the powers assigned to it expressly by the Agreement Establishing the Bank, exercises all the powers delegated to it by the Board of Governors. The Board of Directors consists of 11 Directors. Accordingly, each Member State appoints a Director and an Alternate Director, with full powers to act for the Director, when the Director is not present.

Subject to the relevant provisions of the Agreement Establishing the Bank, the Board of Directors is empowered to take decisions concerning the business of the Bank and its operations, in conformity with the general directions of the Board of Governors; to submit the accounts for each financial year for the approval of the Board of Governors, at each Annual Meeting and to approve the budget of the Bank.

The President

The President is the chief executive and legal representative of the Bank and the Chairman of the Board of Directors. In the above capacities, and as a Chairman of the Management Committee, he conducts the current business of the Bank under the direction of the Board of Directors. In accordance with Article 29 of the Establishing Agreement, the President holds the term of office for four years.

The President is also responsible for the organisation, appointment and dismissal of the officers and staff, in accordance with the rules and regulations adopted by the Board of Directors. The Board of Governors appoints the President of the Bank, who may participate in the meetings of the Board of Governors, without voting power. All matters requiring consideration or decision by the Board of Directors are recommended to the Board by the President.

The Management

In accordance with Article 30 of the Agreement and the decisions of the Inaugural Meeting of the Board of Governors, the Board of Directors has appointed the Vice President Banking, the Vice President Finance and the Secretary General of the Bank, to three-year terms of office. Their respective authorities and responsibilities have been defined by the Board of Directors to include the main operational and administrative functions within the Bank.

The Management Committee comprises of the President (as Chairman), Vice President Banking, Vice President Finance and the Secretary General.

All policy matters pertaining to the key aspects of the strategy, performance and financial soundness of the Bank are considered by the Management Committee, which ensures that they are duly observed. In the absence of the President, one of the Vice Presidents chairs the meetings of the Management Committee.

Audit Committee

The Board of Directors establishes the Audit Committee, which reports directly to the Board of Directors. Membership in the Audit Committee consists of the President (as Chairman), two BSTDB Directors, the Head of the Internal Audit Department and the General Counsel.

Members of the Board of Directors, who serve as members of the Audit Committee, are appointed by the Board of Directors on the nomination of the President following proposals by the Directors. Directors who are members of the Audit Committee serve in this position for one calendar year and are normally appointed at a Board of Directors meeting in the final quarter of the preceding calendar year. If a member Director leaves before the end of his/her term, a successor is appointed for the remainder of the term.

As an independent body reporting directly to the Board of Directors, the Audit Committee verifies that the operations of the Bank have been conducted and its financial books are kept in proper manner. The Board of Directors takes note of the report of the Audit Committee and its conclusions and of the statement by the Audit Committee, before submitting the Annual Report of the Bank to the Board of Governors for approval.

Other Committees

The Board of Directors has also established four other special committees for conducting the Bank's daily operations:

- Assets and Liabilities Committee (ALCO)
- Credit Committee
- Recruitment Committee
- Purchasing Review Committee

Additionally, specialised committees as exemplified below will in due course be established by authority of the President to facilitate strategic and important operational decision-making within the Bank:

- Human Resources Committee
- Information Technology Steering Committee

A specific charter specifying membership, responsibilities, authorities, etc. governs the work of each committee. Other committees may be established at the discretion of the President of the Bank, to facilitate strategic and important tactical level decision-making. Membership to these committees will normally be comprised of senior management and other staff, as stipulated in the relevant rules.

Organisation structure of the Bank

Under the responsibility of the President and each Division Head (Vice Presidents and Secretary General) are departments reporting to them as designated in the Organisation Chart of the Bank. The President and each Division Head has direct control and accountability within the framework of the organisation structure that delineates their respective authorities. Responsibilities are duly segregated among the departments, to enable the system of checks and balances of the Bank's activities to function, both effectively and efficiently and in accordance with industry best practice.

The organisational chart of the Bank is shown in ANNEX

A year of transition: 1999 market conditions in the Black Sea region

II.1 The operational environment in the Black Sea Region

The economies of the Black Sea Economic Cooperation (BSEC) Region achieved varying results during 1999. A number of BSEC transition economies, mainly those associated with CIS, continued to feel the lingering aftershocks of the 1998 Russian financial crisis, but also showed, including Russia itself, signs of absorbing the negative impact and 'turning the corner'. On the one hand, inflation levels rose as a result of the devaluation of national currencies, lack of investor confidence, and in some cases looser monetary policies to cover fiscal deficits. Growth levels suffered, as the initial decline in the Russian economy hurt neighbouring economies as well. On the other hand, most countries were able to sustain the hard earned macroeconomic stability achieved in previous years, and to remain committed to the tight fiscal and monetary policies that helped to achieve this stability. Some took the crisis as an opportunity for further reform, to strengthen financial sectors and to push through other essential structural reforms. However, this was not universal, and thus the positive progress is mixed with cases of continuing uncertainty.

A second shock that hit the region in the first part of the year was the Kosovo crisis. Despite initial fears that it could have devastating consequences for the fragile macroeconomic stability achieved by certain BSEC Members, quick resolution of the conflict, and the initiation of the Stability Pact for South-eastern Europe mitigated the fears and created a climate of guarded optimism for the western portion of the BSEC region. Beneficiary states have committed to sustaining macroeconomic stability and expanding and deepening structural reforms in their economies, and bilateral and multilateral donors have pledged to make considerable amounts of official aid available to support these efforts. Nevertheless, the crisis did create certain difficulties, including a lingering crisis of confidence among private investors, and it perpetuated the region's geographic isolation from potential markets in Western Europe, as the most direct routes through Serbia and along the Danube continues to be blocked.

Initial indications suggest that intra-regional cooperation, as measured by trade and investment flows, grew during 1999. Part of this involves recovery from the aforementioned crises as the affected BSEC economies restored stability. However, the prospects for trade also improved and intra-regional foreign direct investment not only recovered, but also more importantly showed a dynamic business confidence that should carry over into the year 2000. Greek, Russian, and Turkish companies were at the forefront of this intra-regional investment.

Member states' ties beyond the BSEC region also expanded during 1999. Most significant were the confirmations of Bulgaria, Romania and Turkey as formal European Union candidate countries. In addition, a number of CIS transition economies made progress in their effort to reform trade and economic policies in order to become eligible for full membership in the World Trade Organization.

Volatility of world commodity prices, particularly oil, had a mixed effect upon the region. The sharp rise in the world price of oil proved a boon to major exporting countries such as Azerbaijan and Russia, allowing them to improve their external positions and to increase fiscal revenues. However, in most of the other countries that are net oil importers, the price rise exacerbated trade deficits and fuelled inflationary pressures.

A key underlying factor affecting the degree of success achieved by the BSEC Member economies has - to a considerable extent - been the respective abilities of these economies to preserve domestic economic stability, and their ability to react flexibly to the adverse shocks experienced in recent years. The amount of progress recorded by the individual countries in the Region in minimizing domestic and external deficits, in restructuring the economies, in liberalizing markets, and in establishing well-regulated financial markets have all been instrumental in the varying degrees of success achieved. In particular, BSEC transition economies that have taken bolder structural measures towards establishing a fully-fledged market economy, have seen the emergence of a new private sector that has contributed to overall economic growth and which accounts for most of the recorded increase in GDP. In other Member countries, economic and political weaknesses and uncertainties which characterized the business environment, have manifested themselves in lower entrepreneurial initiative and hence in more modest investment and economic performance.

II.2 Overview of the BSTDB member countries

Albania weathered the shock caused by the Kosovo crisis, and after a temporary economic downturn, was able to return to the pattern of high growth that has characterized the economy in recent years when it has not faced crises. The resilience demonstrated by the economy appears paradoxical. Despite some growth in 1999, the industrial base is small, and declined considerably during the 1990s. In addition, Albania runs huge trade deficits, and large public sector and current account deficits. Yet Albania also has one of the highest rates of growth in Eastern Europe, an appreciating currency, comfortable foreign exchange reserve levels, and manageable inflation that dipped to single digits in 1999. Albania has achieved a strong private sector response in certain sectors of the economy -- agriculture, trade and construction -- more than making up for the decline in other sectors. In addition, it has enjoyed access to high levels of foreign assistance, mostly grant or concessional, and remittances (roughly 15% of GDP) which have provided a steady flow of foreign exchange. The launch of the Stability Pact for South-eastern Europe in 1999 has not yet provided much additional financial assistance, but it has helped to improve the economic climate and create positive expectations via the Pact's framework of Government committing to sustain macroeconomic stability and undertake comprehensive structural reforms, and donors pledging to provide financial resources to back the commitments of the Government.

Armenia's economy in 1999 continued the process of consolidating the macroeconomic stabilization achieved in the latter part of the 1990s, even as it tried to manage the shocks created by the 1998 financial crisis in Russia. Growth slowed relative to 1998, to approximately 4% in real terms, as industrial production, output in the transport and services sectors, exports, and workers remittances and transfers were all adversely affected by the Russian crisis. In addition, non-residents' demand for Armenian government treasury bills declined and foreign investment inflows slowed considerably. This indicates that while much of the impact of the crisis was absorbed, they continue to play a negative role. The longer-term structural challenges for the economy remain unchanged, and continue to form the factors that will determine the level of growth, and the composition of this growth in the coming years. Chief among these is the country's geographic isolation and lack of easy access to potential markets, as well as the low levels of other types of activities that generate foreign exchange (e.g. tourism). Development of strategies that overcome, or by-pass these limitations, will be crucial to putting the economy on a path of sustained high growth. Armenia has succeeded impressively in achieving macroeconomic stabilization, and in sustaining it, even as it institutes reforms to develop the financial sector and to create the basic framework of a market economy with competitive conditions for commercial and investment activity. Other reforms which continued in 1999 and the sustainment of which will be essential for continued stability and catalysing growth include industrial restructuring and reduction of state control over industry, together with increased emphasis on enhancing the services sector.

Azerbaijan has recently been the scene of successful macroeconomic stabilization policies targeting sound economic growth. The success achieved with regard to economic stabilization has provided the IMF and the World Bank with sufficient reason to provide financial support to further reform initiatives. While such policies have contributed considerably towards high GDP rates of growth in the past, the tendency in 1999 was an overall slowdown in economic activity, which continued the negative trends of 1998. In 1999 GDP grew by about 4%, down from 10% in 1998. Non-oil manufacturing sectors declined considerably. The trade deficit remained worryingly high, with the current account deficit at about 27% of GDP. Due to poor tax collection both arrears and the budget deficit widened, with the consolidated general government deficit at about 4% of GDP almost the same level recorded in 1998. The high trade deficit lead the authorities to implement a controlled depreciation of the Manat, which together with other measures aimed at increasing competitiveness of Azeri goods and services and reducing demand (cutting expenditures) is expected to bring the trade and current account deficit to sustainable levels. However, gross international reserves remained in the vicinity of three months of imports. Foreign debt was kept at manageable levels of about 21% of GDP. Real interest rates rose sharply and bank credit to the private sector remains very limited. Meanwhile, Azerbaijan continues to take important steps towards reforming its banking system, where liquidity problems worsened in 1999. While all these steps are to be regarded as being in the right direction, Azerbaijan's economic future will depend primarily on accelerating the pace of economic and public sector reforms, and on rational utilization of petroleum revenues.

Bulgaria's economic performance was negatively affected in 1999 by a combination of external factors that include the Kosovo crisis, and the lingering effects of the 1998 Russian financial crisis that created demand declines in destination countries for Bulgarian exports. GDP Growth fell to 1.5% for 1999, below the medium term target rates of 4-5% to which Bulgaria had aspired at the time of macroeconomic stabilization in 1997. External crises notwithstanding, macroeconomic stability was preserved, in part due to tight fiscal and incomes policies implemented in the public sector. The other key factor in preserving macroeconomic stability was the continued adherence to a tight monetary policy underpinned by the country's currency board arrangement. Supply of domestic currency is regulated by availability of foreign exchange that is sold at a fixed exchange rate; the arrangement precludes the Central Bank from financing deficits by printing money or extending credit to the Government.

Among the achievements for 1999, privatisation and restructuring advanced further, banking supervision and regulation continued to improve, and land restitution and titling progressed. These all comprise elements of key structural reforms that will be essential for the government to translate successful stabilization into sustained long-term economic growth. A major and far-reaching event was the start of the official accession negotiations with EU, decided in Helsinki in December 1999.

Georgia. Since most Georgian trade is with other CIS countries, the impact of the Russian financial crisis of 1998 was severe, choking off a recovery in exports. The impact of the crisis continued to affect the country during 1999, and as a result growth grew only slightly over 1998 levels to 4%. This is well below the recovery growth rates of 10% or more during 1996-97 and below the levels for which the Government had hoped. One positive characteristic is that the growth has been private sector driven; in particular, services, construction, and agriculture are the sectors that have shown the greatest recovery while large, state-owned industrial firms have fared poorly.

Debt servicing requirements remain high for the economy, and this has forced the government to continue tight fiscal and monetary policies. Adherence to these policies have been notable successes, and despite the increase in inflation in the aftermath of the 1998 crisis, it remains manageable, reaching double digits for 1999, but expected to drop back to single digits in coming years. The lingering impact of the 1998 crisis on regional business confidence still leaves economic activity in a rather depressed state and has meant that foreign direct investment has lagged behind government expectations. Combined with the poor performance of exports and the lack of other sources of foreign exchange, this has meant that international financial institutions remain the principal sources of foreign capital inflows.

Greece maintained its brisk pace of development in 1999. Preliminary GDP growth estimates for 1999 point to a 3.5 % growth rate, led essentially by buoyant investment activity and higher levels of consumption sustained by increased consumer lending. Continued implementation of the tight fiscal and monetary policies adhered to throughout the 1990's has resulted in achievement of, and sustained compliance with, the key indicators stipulated in the 'Maastricht criteria' for accession into the European Monetary Union (EMU). The most difficult criterion was the one regarding inflation, particularly in view of the rise in oil prices during 1999; however, despite a small increase above forecast levels, the government successfully met the criterion by keeping inflation at 2.2%, within 1.5% of the average inflation rate for the three lowest inflation countries in the European Union (EU). Thus, Greece will have met or exceeded all the necessary targets for EMU accession in 2001. Dramatic improvement in revenue collection has allowed the government to do so without having to cut spending. This has permitted greater levels of public investment that, combined with EU support and growing private consumption, have all helped to fuel growth. Initial worries about negative effects from the Kosovo crisis proved unfounded, and thus growth resumed with little adverse impact. Investment activity in neighbouring countries slowed in the first half of the year, but following resolution of the crisis, and the onset of the Stability Pact, Greek enterprises resumed their investment activity in neighbouring BSEC countries with even greater interest.

Moldova was one of the countries most severely affected by the Russian financial crisis. As a result, the modest growth of 1997 was reversed, inflation soared, the fiscal crisis deepened, and the period of sustained exchange rate stability ended. In the first half of 1999 GDP fell by about 5.3% in real terms, following a decline by 8.6% in 1998. The steep decline in the value of exports to CIS countries, which has persisted since the financial crisis, has continued to create adverse repercussions on the Moldavian economy during 1999. The narrowing of the current account deficit was due to a greater contraction in imports, relative to that in exports. The current account deficit reached 21.1 percent of GDP in 1998, but it was expected to fall to 5.4 percent of GDP in 1999 as a result of a significant decline in domestic demand. As a result of the crisis, exports to Central and Eastern Europe, and to the EU, increased in absolute terms as well as in proportion to total exports. Meanwhile the value of the national currency exhibited steep decline, culminating in further widening of the domestic and external financing deficits, which have in turn led to the stock of debt reaching very high levels and in external arrears being incurred. The Central Bank's sound and resolute monetary policy has helped to contain average monthly inflation within a reasonable range, although inflation in Moldova remains among the highest of BSEC Member countries. Under the current circumstances, implementation of resolute policies and strict commitment to the reform process, with appropriate financing support from the international financial community, are of vital importance.

Romania. The slow reform and continuing structural weaknesses contributed to a GDP decline of over 3% in 1999. Although domestic demand contracted, external accounts improved markedly in 1999 with the current account deficit dropping effectively to half its US dollar value in 1998, mostly as a result of an 8.8% increase in exports. One of the major achievement of Romania was the payment of US $3 billion in foreign debt in 1999 (30% of the stock of foreign debt and about 8% of GDP), while at the same time reducing the current account deficit and increasing the net international reserves of the central bank. Inflation remained high at an annual rate of approximately 45%, annual average, while real wages declined by about 1% compared to 1998. The success of restructuring and privatisation efforts aiming to address such weaknesses remained limited. The current economic program is centred around fiscal consolidation and wage restraint aimed at controlling domestic demand, tightening credit conditions, narrowing the budgetary and current account deficits further, and rationalising public enterprises so as to reduce losses and ultimately lower inflation. The eventual success of this economic program will be instrumental in improving economic conditions. In the year 1999, Romania was invited to embark on the process of becoming a member of the European Union, which is expected to foster the economic reforms and have a positive impact on the investment climate in this country.

Russia. The overall contraction and the rise in inflation, ignited by the 1998 financial crisis have been contained, and the economic situation stabilized by mid-1999, with GDP and industrial output rising in the second half of the year. The surge in oil prices and the spur to domestic industry that resulted from the devaluation are two key factors that not only mitigated the negative consequences of the 1998 crisis, but also allowed Russia to show some growth for the year. The industrial growth came in import substituting industries that became more price competitive from the sizeable devaluation which occurred in 1998. Other sectors of the economy, except for construction, were either stagnant or declining. The windfall profits on oil also led to higher revenues from export taxes, thus improving the federal fiscal situation. This in turn reduced pressure for looser monetary policy to cover deficits, thus allowing the Central Bank to tighten the money supply and stabilized inflation, which had surged following the devaluation. Russian firms showed greater interest in undertaking investment activity in neighbouring BSEC countries.

Reforms to address the crisis have been implemented very unevenly, and there has been a general lack of economic reform as a result of continuing political uncertainties. After the parliamentary elections in December 1999 there were positive signs of economic recovery and political stability.

Turkey's economy was in a relatively stable position when on August 17th, 1999 a major earthquake caused enormous damage to the economy. While the exact direct cost of the physical damage is uncertain, partial estimates point to a wealth loss in the range of US$ 3 to 6.5 billion, 1.5-3.0% of GDP. In terms of indirect costs, the earthquake is likely to reduce 1999 GDP by a further 0.6-1.0%.

During 1999, inflation developed along a consistent downward trend. This reflected the stagnant outlook in the economy, in line with the global economy, as evidenced by the sharp contraction in output by an estimated 5 per cent in real terms during the first half of the year. Nevertheless, some progress with regard to structural reforms was achieved. Following the surplus of close to 1% of GDP recorded in 1998, the current account was expected to register a small deficit to the tune of about 0.5% of GDP, in 1999. This deterioration reflects mainly the loss of tourism revenues caused to a significant extent by the earthquake. As regards the capital account, in 1999 foreign direct investment failed to register the long-awaited increase. Meanwhile, as a result of the increased burden of debt repayments, net external borrowing by the public sector grew by a modest US$ 550 million. Net external borrowing by the private sector, including banks, declined substantially in 1999, largely due to the lower level of economic activity, and particularly due to the decline in exports. Notwithstanding the circumstances, Turkish enterprises continued to show an active interest in expanding their markets and investing in other countries of the BSEC region.

Ukraine's economic environment was characterized by uncertainty. A major source of uncertainty and risk is represented by the ability of Ukraine to service its foreign debt, given the very low level of international reserves. The continuous downtrend in output and GDP growth since independence is mainly due to Ukraine's loss of prominence in agricultural and industrial production, as well as to the economic problems being experienced by its largest trading partner, Russia. Low industrial restructuring in general and the slow and uneven pace of privatisation in particular, lie at the core of the country's economic problems. However, 1999 may be the last year of economic decline with signs that growth can be resumed in 2000.

In 1999 GDP declined slightly by less than 1% in real terms, while industrial output increased by over 4%, with production of consumer goods increasing by over 7%. The GDP decline is mostly due to a decline in agricultural output by about 7%. For the first time in the last years, real wages increased (by 3.4%). Inflation increased by around 19%, almost the same figure recorded in 1998. Exports declined by 3.5% and imports declined by about 4%, which resulted in a slight decline in the trade account deficit to GDP ratio as compared to 1998. The government recorded visible success in implementing tight fiscal and monetary policies in the latter half of 1998 and during 1999, managing to achieve significant reductions in the budget deficit. The consolidated budget deficit in 1999 was around 1.5% of GDP, down from 2.2% in 1998. Nevertheless, slow progress in structural reforms remains the major problem for the Ukrainian economy and, in this context, measures to strengthen the financial system need to be considered as a priority.

Growth through Project and Trade Finance:
Banking operations in 1999 and beyond

III.1 Introduction

The main value added of BSTDB is in filling key niches which promote regional economic activity, but which are not adequately covered by other actors at present- either governments, international organizations, or private banks and enterprises.

Apart from project finance, which is the main operational priority for the Bank, one main value added activity refers to provision of direct assistance for small and medium sized enterprises (SMEs), which account for most private economic activity in the Member countries. BSTDB is a regionally located institution that is able to work with much smaller enterprises compared to other institutions, which tend to have much higher minimum project size. Other institutions do provide credit lines through local intermediaries, but weak financial systems, risk aversion, and lack of targeting have been some of the factors which have impeded their effective deployment.

Trade finance represents another underdeveloped activity in the Region, the political risks of which have not been duly addressed by most international institutions, which in turn have generally focused on investment and privatization. In addition, weak financial sectors, traditions of direct trading or barter, and perceived uncertainties about countries' economic situations have all hindered rapid trade development.

A third contribution is to improve the flow of, and the access to, information about the Region, particularly in the corporate and financial sectors. Through its operations, the Bank collects, analyzes, and disseminates information for the benefit of its Bank's shareholders, its clients, co-financiers, and other commercial and development partners.

The Bank aims to be complementary in its activities with those of other international organizations, and to avoid displacing private sector activity. Rather, BSTDB makes possible public and private sector activity that would otherwise not occur for reasons that may include fear of political risks, problems of information, and lack of incremental financing. BSTDB is thus not only a financial institution, but employs its involvement in a project as a signal to co-financiers, commercial entities and investors, encouraging participation.

III.2 Operational strategy

BSTDB's operational strategy is designed to provide enough flexibility to enable it to respond adequately to the changes in political, economic and market conditions. As a result, BSTDB has developed a two-year operational strategy which aims to establish the Bank as a quickly growing, commercially minded institution looking to achieve development impact and enhancement of cooperation in all of its operations, in compliance with internationally accepted sound banking principles.

The Bank's focus is on building a good quality portfolio of relatively liquid assets that mainly include high-yield medium term project finance loans and short-term trade finance facilities, complemented by minimum direct equity investments. This asset structure will gradually be transformed into a balanced portfolio of a) medium to long term projects in both the private and public sectors, b) stand alone equity investment operations and c) a diversified trade finance portfolio by the end of 2001. This asset strategy will ensure, in the early stages of operation, a flexible approach to market conditions while using relatively rapid portfolio turnover and low levels of exposure concentration. This approach will help the Bank generate sufficient cash flow to cover expenditures, maintain quality and extend the asset portfolio. Pricing reflects the commercial risks of projects (including relevant foreign exchange risk exposure) and the country risk. BSTDB seeks to strike a balance between the need of its clients for attractive rates and the Bank's requirement for sufficient risk compensation and return.

In terms of sectoral priorities, the Bank is concentrating on sectors that are crucial for promotion and facilitation of co-operation and trade between the Member countries: in particular, energy, transportation, manufacturing and services, and telecommunications. While the Bank does not seek a certain percentage of private or public sector operations, development of the private sector in the Region is a key objective of operations. Thus, the Bank has initiated programs for the promotion of small and medium enterprises- which account for most of the employment in the Region and which are the most dynamic 'engines' of economic growth.

The operational challenge for BSTDB is to leverage its assets to bring in maximum flows of capital and know-how into the Region. Given its capacity and funding, BSTDB intends to inspire positive movement, ensuring that the operations in which it becomes involved are economically sound and actively assist market development, at sectoral, institutional, and even enterprise level.

BSTDB is first and foremost a regional bank, focused on improving integration within the Region and adding value to the economies of its shareholders. It has not yet established local offices in Member countries, a move that will be dictated by business volume, and the extent to which it proves necessary to have local presence in specific markets. Instead, BSTDB 'knows' its Region, drawing much of its staff from the Region or from institutions which are active in the Region, undertaking thorough research of its markets of activity, carrying out frequent missions to stay on top of developments, establishing working relationships with Member country Central Banks and other public and private sources of economic and business information, and cooperating with other international institutions. In addition, BSTDB works closely with other BSEC institutions, and it enjoys excellent access to the governments of the Region because it draws its Board of Directors from these governments; since there is no resident Director, each country's representative is drawn from the government of the respective country.

III.3 1999 Banking activities

Banking activities during 1999 focused upon building up operations and contributing to the construction of BSTDB's internal infrastructure. The activities followed two parallel tracks: an internal one which involved the development of operational policies and contribution to the establishment of a banking organization; and an external one which involved operational missions to the Member countries, and establishment of contacts with officials from the government, the private sector, and other interested parties as a means to introduce BSTDB on the one hand, but also to establish the basis for future cooperation with these various representatives- including the regular exchange of information.

For BSTDB, 1999 was primarily a year of gearing up for operations, and in this respect establishment of the operational infrastructure of the Bank was a top priority. Therefore, the Bank prepared Country Strategies, a Project Finance Cycle, and a Trade Finance Operational Cycle, as well as concept papers and operational procedures covering its full range of activities including the Business Plan, the Corporate Governance Paper, the Financial Policies, the Portfolio Risk Management and Investment Policies, the Operational Portfolio Management Document, the Pricing Model, and the Concept Paper for Technical Assistance and Co-financing.

In parallel, the country missions, along with the Bank's inauguration ceremony, conferences and seminars, all offered an opportunity to introduce the Bank to clients, shareholders, and other interested parties as part of the effort to introduce the Bank in its market of operations and establish its place in the financial sector of the Region.

III.4 Country strategies

A key outcome of the Bank's initial country missions in 1999 was the preparation of Country Strategies- concise, operationally oriented documents which summarize recent country economic performance, key issues facing the country, principal country aspirations, and institutional frameworks for business activity and foreign investment. The strategies then lay out the Bank's priorities for project finance and trade finance activities for the coming two-year period. There are many issues common to all the Member countries, chief of which is the need- and desire- to increase regional cooperation and to lay the framework for greater economic integration. However, there are also different prospects and challenges facing each of the Member states, forcing the Bank to tailor its strategy to the needs and desires of each country, within the context of the Bank's operating mandate.

In general, the Country Strategy depends upon the levels of development and macroeconomic stability of each particular Member. If the Member is at a stage where macroeconomic stability remains elusive, then the Bank's strategy is to leverage activities in a manner that will help move in the direction of achieving stability. Cooperation with other international financing institutions will generally play a larger role to help such a country until such time as sufficient stability improves the climate for private sector activity. Private sector operations would be limited in scope and nature.

For the majority of the Bank's Members, the main challenge is not achieving macroeconomic stability, but rather entrenching the stability, improving the economy's resilience in the face of exogenous and endogenous shocks (such as the 1998 Russian financial crisis or the 1999 Kosovo conflict), and most importantly, carrying out the necessary structural reforms to bring about the preconditions for sustained growth. Cooperation with other international financial institutions continues to play a role, for projects that aim to develop market institutions, advise on legal and institutional reforms, build infrastructure, and facilitate the establishment of competitive frameworks through activities such as sectoral restructuring and enterprise privatisation. However, there is a greater emphasis on private sector operations, facilitating intra-regional trade and helping to stimulate private sector activity and investment.

Improving access to capital is important even for the more developed and market oriented Bank Members. But while they have certainly been relatively more successful in attracting outside private capital, there still exist local disparities; therefore, provincially focused operations may be carried out, and firms from these countries investing in other countries will be supported.

Albania

The quick resolution of the Kosovo crisis and successful implementation of the Stability Pact will generate substantial opportunities for increased trade and integration with neighbouring states. The fledgling financial sector of the country means that BSTDB can be a significant presence in helping to promote trade. The volumes generated may prove a significant catalyst within Albania, where the financial sector provides almost no support to commercial transactions. Due to financial sector weaknesses, BSTDB will seek to work with financial intermediaries with capable management and strong support. Only short-term products will be offered initially.

In project finance, BSTDB will seek to participate with private firms engaged in sectors such as food processing, consumer products, construction materials and textiles. In addition, BSTDB will seek to support economic infrastructure development, and will take an active interest in cross border infrastructure and possibly telecommunications. Since almost all enterprises in Albania fall within the category of small to medium enterprises (SMEs), BSTDB will explore ways to provide support to SMEs, wary of the fact that the sector has attracted considerable attention, but there has been little in the way of successful results.

Armenia

Financing needs in Armenia are extensive; almost all sectors of activity, telecommunications, energy, transport and industry, demonstrate a need for investment. BSTDB will focus primarily on two activities for its project finance program: (i) export oriented industries and (ii) transport, for which existing bottlenecks, and the relative isolation of the country pose formidable obstacles for development in other sectors of the economy.

BSTDB trade finance products will be of a short-term nature; movement to longer-term products is not planned in the initial phase, and may be considered at a future date depending on the evolution of the financial sector and demand from Armenian exporters and importers. Identifying partner commercial banks will be challenging, but BSTDB hopes to contribute to building capacity and confidence in promising local banks.

Azerbaijan

BSTDB will concentrate its activities in Azerbaijan on providing financial support in particular for projects in non-oil sectors. It plans to establish a post privatisation facility to help already privatised enterprises to restructure and develop, as a way of supporting high development and transition impact, social impact, mobilization of external funds, and financial sector development. As a long-term priority BSTDB will support member countries investors to participate in privatisation in Azerbaijan. The Bank may participate in privatisation wherever it complies with the policies and strategy of the Bank. The Bank will also consider financing projects in telecommunications, transportation, manufacturing, agribusiness, and oil and gas industries.

For trade finance, BSTDB will focus its support in areas of the Azerbaijan economy that have potential, but require additional support. These include support for purchase of equipment and other inputs in order to increase agricultural production and to improve food processing, packaging and canning industry. Although BSTDB prefers to support the production and export of value-added goods, it recognizes that in some economies support needs to be provided also for exports of raw materials and semi-processed goods.

Bulgaria

Bulgaria's central position in the BSEC region makes it a promising candidate for projects that contain cross-border cooperation elements among member countries. Since much of the investor reluctance- domestic and external- which affects the country adversely is due to perceptions of regional and country risk, there is considerable scope for BSTDB to provide genuine 'additionality' or value added, to operations which otherwise would not occur. The key will be identification of private firms with solid management and good track records that are involved in sectors such as food processing, consumer products, or textiles. In addition, there is scope for BSTDB participation as a co-financier in transport, cross border infrastructure, and possibly telecommunications.

The full range of BSTDB trade finance products will be made available to Bulgarian enterprises. Initially, these products will be of a short-term nature, and movement to longer-term products will be determined by the evolution of country and financial sector risks, as well as demand of Bulgarian firms for longer-term instruments.

Georgia

Georgia's geographical position as a crossroads of the eastern Black Sea region places it at an advantageous position as far as transport and communications potential are concerned. The energy sector will also be of particular interest, both infrastructure for transit of energy resources and power generation activities- the latter depending upon structural reforms and the pace of privatisation. The best prospects for working with private firms will involve dynamic medium sized firms that are involved in export oriented or import substituting activities. This includes much of the agribusiness sector, and certain industries that are export oriented. Restrictions on provision of sovereign guarantees, agreed to by the Government as part of the IMF program, will limit the prospects for certain types of public sector lending which would normally involve a sovereign guarantee.

BSTDB trade finance products will be mostly of a short-term nature; movement to longer-term products is unlikely in the initial phase, but will be determined by the evolution of country and financial sector risks, as well as demand of Georgian exporters and importers for longer term instruments. Identifying partner commercial banks will be challenging, but BSTDB hopes to contribute to building capacity and confidence in promising local banks.

Greece

In view of the status of Greece within BSEC, project finance prospects within Greece are more limited than in other member countries. There is little need for BSTDB participation in activities in Greece, since private firms can access funds more quickly and cheaply through private banks. There may be participation in cross-border initiatives, and intra-BSEC investment projects where participants may request BSTDB participation. In addition, shipping will draw attention, since it is by nature a sector in which the regional cooperation prospects are high. There also exist possibilities for cooperation with Greek organizations assisting counterpart organizations in other BSEC countries, as Greece is already active in providing aid in a number of sectors.

There is considerable scope for project finance activities involving Greek firms investing in other BSEC countries. Many Greek firms are looking to neighbouring countries for the development of new markets, and they have been active in numerous BSEC countries. This trend is expected to continue, and as BSEC countries recover from the Russian financial crisis of 1998 prospects will improve, encouraging increasing numbers of Greek firms to venture abroad further.

In trade finance there is also great potential for cooperation with Greek firms to assist in the promotion on intra-regional trade. The increasing export orientation of Greek firms to the BSEC region, combined with the perceived risks of doing business in other BSEC countries, suggests that BSTDB should be able to work with Greek banks and their client firms to help them benefit from the guarantee program, and buyer credits.

Moldova

The BSTDB's primary strategy for support of the Moldova economy lies in the following important areas:

In trade finance, the key aim is to promote Moldova exports. The Bank considers it has an important role to play to promote increased trade flows between Moldova and the other member countries. This would reduce Moldova's vulnerability to external shocks, would promote private sector development, and would employ export growth as an engine for economic development and better utilisation of domestic resources. In addition, the Bank will seek to provide assistance for the creation of a Moldova export promotion agency.

BSTDB will place great emphasis on private sector development. This will entail supporting the development of small and medium-sized enterprises (SMEs) through development of local financial intermediation. On a case-by-case basis, the Bank will examine the possibility of supporting specific enterprise restructuring and privatisation assignments. In addition, the Bank intends to contribute to the development and privatisation of a competitive private sector in the financial sector.

Romania

In the first years of operation the Bank will focus on co-financing with other international financial institutions medium term, medium size, public infrastructure operations- in particular transport, energy and telecommunications. The highest priority would be for cross-country operations with strong regional cooperation impact. In addition, the Bank will seek to support private sector development, in particular locally owned and incorporated medium size businesses in manufacturing of goods with export potential. The Bank will particularly seek to mobilize capital through credit lines and promotion of equity participation.

For trade finance, the Bank will seek to foster trade among the region countries, aiming at superior utilization of existing fixed capital and labour capacities, and increasing value added of export oriented producers of goods and services. The full range of BSTDB trade finance products will be made available to Romanian enterprises. Initially, these products will be of a short-term nature, and movement to longer-term products will be determined by the evolution of country and financial sector risks.

Russia

The project finance strategy for Russia will involve focusing on projects in the regions of Russia near the Black Sea- primarily Rostov, Krasnodar, and Stavropol. Investments involving regional BSEC cooperation that are outside these three regions will also receive due consideration. The reasons for this include the geographic proximity of these regions to the other BSEC members, the relatively lower share of interest and initiatives from international financial institutions they have received, and the fact that since Russia is so vast geographically, the best way for the Bank to achieve impact is by focusing on specific areas where the prospects to add value are greatest. The best opportunities for business in these regions are with firms involved in food processing and light industry, especially firms which are involved in 'import substitution' activities, or which carry out exports. These firms tend to be more competitive and are more immune from the effects of the crisis, or beneficiaries thereof. Project finance activities will also involve working with a number of Russian firms which have shown increasing interest in undertaking investments in other BSEC member countries.

The trade finance strategy for Russia will not be regionally focused. Rather, it will seek to promote export capacity of Russia, and to facilitate trade between Russia and the other member states. Beginning initially with short term products, the Bank will try to promote exporting firms in the industrial sector, for while Russia is unique in enjoying large trade surpluses, these are due primarily to commodity exports which are notoriously vulnerable to price fluctuations. The competitiveness of the industrial and processing sectors has declined over the course of the 1990s, and even firms that have successfully restructured still encounter problems of access to finance, and the general problems associated with country risk. Such firms will form the ideal target clients for the Bank's trade finance program.

Turkey

In the first years of operation the Bank will focus on (i) co-financing with other IFIs and the Turkish government medium term, medium size, public infrastructure operations and regional development projects; and (ii) supporting private sector development, in particular locally owned and incorporated medium size businesses in manufacturing of goods with export potential, and Small and Medium Size Enterprises particularly in the less developed parts of the country. However, a priority for BSTDB will also be to partner with Turkish firms investing in other member countries. Turkey is already an important investor in several BSTDB member countries and BSTDB involvement would result in increased capital flows from Turkey to these countries and would foster economic cooperation in the Black Sea region.

In trade finance, there is great potential of cooperation with Turkish firms and banks to assist in the promotion of intra-regional trade. In particular, BSTDB should be able to work with Turkish banks to provide additional resources to assist exports, and to work with local banks and their client firms to help them benefit from the guarantee program, and buyer credits.

Ukraine

The BSTDB's primary strategy for support of the Ukrainian economy lies in the following important areas: diversification of the sources of energy supply; increasing Ukrainian exports, primarily to BSEC countries; providing financial support for purchases of necessary capital goods for use in agriculture and manufacturing; and supporting small and medium sized private sector development.

A number of sectors of activity- energy, telecommunications, transport and industry, show an urgent need for investment and include a number of initiatives, which involve strong regional co-operation elements. BSTDB will therefore pro-actively seek lending opportunities chiefly in these sectors.

III.5 Project Finance operations

When providing corporate and project finance products, BSTDB attempts to strike the right balance between application of sound banking principles and obtaining optimal fulfillment of its mandate. The projects considered so far are first of all 'bankable' projects with well-developed concepts, reputable sponsors and adequate financial returns. Furthermore, the projects promote synergies among the economies of the Member states and ideally bring about increases in regional integration within the BSEC Region.

The main project finance instruments to be offered by BSTDB include (a) loans (b) equity investments and (c) guarantees. In addition, BSTDB is developing facilities that will enable it to provide technical assistance support for transfer of skills and know-how for business related activities such as plan preparation, accounting, and improving management. The Bank uses its involvement in an operation as an indication of the operation's attractiveness, and utilizes its preferential status as an instrument to mitigate investors' concerns about country risks, permitting investors to assess operations primarily on the basis of the commercial and market risks involved. This in turn enhances the attractiveness of the Region for private capital, and its accomplishment will be critical for achievement of the 'multiplier effect' of bringing in a factor of additional funds for every unit of funds invested (at least two to one) for the benefit of the Member countries.

Although project financing levels may be low given overall needs, the impact from the operations can be larger if they achieve positive externalities such as environmental improvement, transfer of technical and market know-how, and better governance. The latter are particularly critical, and can be achieved in Bank operations through the adoption of practices in Bank operations that establish precedents for efficient, competitive behaviour and responsible corporate governance. These 'best practices' can help institute proper market procedures and establish 'behavioural thresholds' which other firms must meet if they wish to attract investment flows or even survive in an open competitive market.

As a diverse source of project and corporate financing, BSTDB's objective is to become the pre-eminent provider of developmental long-term financing in the Black Sea Region. The Region itself is demonstrating dynamism and the need for more complex financing instruments will be increasing accordingly.

During 1999, BSTDB initiated work on soliciting and finding prospective projects. The Bank originated a pipeline of 140 eligible project finance proposals, of which approximately 80% are for private sector operations. In 1999, BSTDB also approved its first project- the Trans-Balkan Gas Pipeline, a cross-country project that directly and indirectly will benefit six Member countries, improving the efficiency and speed of natural gas transmission within the Region. It provides an ideal example of the type of project BSTDB wishes to support, for in addition to its trans-regional character it is a private sector operation and it involves extensive mobilization of funding from other international financial institutions.

The rapid development of the project pipeline represents empirical confirmation of the continuing need for development financing in the Region and provides strong indication that the Bank has an important role to play in facilitating cooperation between the Member countries. The proposals covered every Member country and with minor exceptions were well distributed among countries and across sectors. The broadly defined manufacturing sector accounted for 30% of the proposals, with the energy and transportation sectors accounting for about 17% each.

Overall, around 10% of the projects involve several Member countries and cannot be attributed to a specific local market. These mostly involve cross-country infrastructure development, and enjoy highest priority, since they fully meet both the developmental and regional cooperation aspects of the mandate. Most of the projects directly or indirectly contain elements of cross-border operation, with private sector proposals usually involving investments from a firm from one country in another, thus promoting regional cooperation in the private sector.

The Project cycle

Among the key achievements of 1999 was the finalization of the Project Cycle Policy Document and its attendant Operations Manual. The Project Cycle Document provides the policy framework for BSTDB's loan, investment guarantee, and equity investment activities. The Project Cycle aims to achieve the correct mix of efficiency, flexibility, transparency, and consistency with sound banking principles and prudent banking practices. Client orientation is also a central pillar of the Bank's approach. For each of the Project Cycle steps there are responsibilities and authorities of three types: 'primary' responsibility for a process or activity, a 'review' role requiring a specific analysis or formal opinion, and 'supporting' roles providing analysis, opinions, and other inputs either on a regular or an 'as needed' basis.

In striking a balance between the need for proper management supervision and cost and time-effectiveness of preparation, there normally are two steps of senior BSTDB management review in the Project Cycle prior to presentation to the Board of Directors for Final Approval. The first involves Concept Clearance during the Initiation stage, giving the go-ahead for allocation of Bank resources to the project. It is intended to ensure that the Bank's resources are not expended on deals that have little likelihood of approval or are less attractive, in terms of development and cooperation impact, in comparison with other opportunities available. The second stage follows appraisal and finalization of the project's key features, such as scope, covenants, and pricing. It may come before or after finalization of legal documents, depending upon whether it is a public (sovereign) or private (non-sovereign) sector operation, and the specific requirements of the project. Board of Directors approval is currently a requirement for every project, and occurs after the main Project Legal Agreement has been finalized.

Co-financing

BSTDB procedures limit Bank participation to 35 percent maximum of total project financing- a figure that is even lower if equity is involved. One of the intentions of this limit was to oblige the Bank to mobilize funds of even greater value for each project in which it participates. Therefore, co-financing, irrespective of specific forms, is a necessity for every single Bank project, and is strongly encouraged in trade finance transactions as well. As a result, the Bank has established relations with a number of international financial institutions, and is exploring co-financing opportunities with those that are active in the BSEC Region. Approximately 21% of the projects in the pipeline directly involved co-financing with other international financial institutions. In addition, it has contacted and actively seeks to develop working relationships with institutions such as the European Union, the Governments of Non-Member countries interested in the BSEC Region, and commercial banks.

The key elements of the Bank's co-financing strategy include:

- co-financing from official sources in order to strengthen regional development and cooperation between the Member countries
- co-financing from market sources on a joint but more preferably parallel co-financing basis mainly for private sector projects
- co-financing with other international financial institutions, both joint and parallel.

III.6 Trade Finance operations

A distinguishing aspect of the Black Sea Trade and Development Bank (BSTDB) is its emphasis on supporting and increasing regional trade. For the BSEC Region, official FOB export statistics show that approximately USD 23 billion in intra-regional trade was conducted in 1998. It has been estimated that this number would be approximately 15% to 20% higher had unofficial trade been included. This represents a very small portion of regional GDP; given the population sizes, geographic proximity and the complementary nature of economies in the Region, the number could be much greater.

Since many of the Bank's countries of operation currently lack an export credit agency, or operate with severely limited resources, BSTDB's trade products are designed to "fill the gap" and promote export sectors within the Region. BSTDB will help regional exporting companies to compete better with companies from economies with developed banking systems that are backed by strong ECAs.

BSTDB has devised a trade finance strategy for 1999 and 2000 whereby it focuses exclusively on introducing its short-term products, involving tenors of no greater than 90 days and in some markets 180 days, consisting of a Pre-Export Financing Program. The Pre-Export Finance Program provides loans to selected banks in the Region for on-lending to exporting companies. Over time, and as market conditions warrant, short-term products will support transactions involving tenors of up to 360 days. The intention is to build a short-term portfolio, thereby turning assets over as quickly as possible and generating good primary business for the Bank. Focusing on short-term business in the first full year of operations will also help balance the average tenor of the Bank's over-all portfolio and make for a stronger basket of assets from a risk management point of view. Moreover, by concentrating on short-term products initially, the Bank will also be in a position to support more exporting/importing companies in the Region, than if it were to concentrate on medium/long-term transactions from the outset.

The Bank is in the process of negotiating Pre-Export Finance agreements with a number of financial intermediaries in the Region. During 1999, BSTDB approved its first two financial intermediaries for trade finance activities- Turk Eximbank (Turkey's export credit agency) and Vneshtorgbank (Bank for Foreign Trade - Russian Federation). At the end of 1999 the number of additional banks under consideration in the Trade Finance pipeline was 20. Each potential bank has been identified by BSTDB as being active in trade finance activity and showing promising capacity and scope for trade finance support and business.

As BSTDB develops its business relationships in the region, and as resources grow, the Bank will introduce more products into the trade finance program in support of its mandate. BSTDB plans to introduce Guarantees on trade instruments issued by selected banks, and medium term products, including Single and Multiple Buyer Credits, and Supplier Refinancing for intermediary banks located in the Region. The term of these products normally ranges from two to three years and may be extended to five years. These products will contribute to increasing trade volumes among Member-countries and improving the competitive position of exporters vying internationally for contracts against companies that are well supported by international commercial banks, or Western ECAs.

Minimum regional content requirements exist for most products and transactions to ensure the Bank's capital is employed in such a way as to provide maximum benefit for shareholder countries. Moreover, the importation of capital goods and other products from Non-Member countries will generally not be supported by the Trade Finance Program, as the Bank wishes to provide maximum support to production in the shareholder countries.

While the BSTDB's mandate is mostly focused on promoting and supporting intra-regional economic integration, the Bank has a strong interest in working with IFIs, non-regional export credit agencies and international commercial banks. The mobilization of additional funds to finance trade in the Region is a motivation for cooperation with these financial entities. In addition, information-exchange, risk sharing and the pooling of administrative resources are strong motivating factors for BSTDB to build strong working relationships with non-regional financial institutions.

Trade Finance Cycle

The Trade Finance Cycle is committed to the principles of efficiency, flexibility, transparency, orientation to client needs, and consistency with sound banking principles and prudent banking practices. Most trade finance business will be conducted through Financial Intermediaries (FIs) in the Member countries for reasons which include (i) FIs are likely to possess more comprehensive information on existing clients, and (ii) this approach permits the Bank to substitute the risk of the ultimate borrower with that of the FI - lowering (in virtually all cases) the Bank's risk profile for its trade finance business.

The approval process for an FI involves careful credit analysis, including trend analysis (past and projected), ratio analysis and comparative analysis. Final approval of a credit line rests with the Board of Directors. Upon signature of an Agreement, the Bank initiates business within the parameters dictated by the approved limit and tenor. In the event of a Financial Intermediary wishing to draw on its approved BSTDB Credit Line, it must provide the Bank with information including the nature and tenor of the transaction, information on the parties involved in the transaction, and a description of the goods/services to be traded. BSTDB is committed to determination of eligibility without delay, and prompt provision of authorization.

III.7 Economic analysis

One of the most important determinants of BSTDB participation in an operation is the expected economic impact. The Bank carries out an independent economic analysis of every operation, during which determination is made of what additional economic costs and benefits the operation may have over and above the direct monetary costs and benefits which are typically captured in the financial analysis. In addition to analysis of market distortions or failures, displacement effects and enumeration of externalities, there exists an important externality, which on its own forms a portion of economic analysis for a project; namely, consideration of the regional cooperation impact of the project. While this is not a traditional element of economic analysis, the very nature and mission of the Bank obliges it to pay considerable attention to both parts of its dual mandate- achieving development impact on the one hand, and fostering regional cooperation and integration on the other. Normally, these two aspects enjoy considerable overlap, and it is rare to find a case where the one occurs at the expense of the other. However, there may be acceptable projects which prima facie demonstrate developmental benefits below a hurdle rate, but which demonstrate high regional integration prospects. Regional cooperation impact is not considered as an end in itself, nor can it be reviewed in isolation, but it does form a portion- often an important portion- of the overall assessment.

III.8 Environment

The environmental mission of the Bank is to integrate environmental concerns into the assessment procedures of Bank financed operations and to be an effective intermediary and interlocutor for the provision of clean technologies in a cost-effective and economically feasible manner. Since the ultimate objective of the Bank is the promotion of sustainable development in Member countries, the Bank is determined to promote environmental soundness in all its operations. At the very least, the environmental 'neutrality' of an operation must be ensured. The Bank gives special attention to preservation of natural conditions and pollution prevention of ground water, wetlands, coastal areas, natural parks and protected areas, forest resources, fisheries and wildlife; the end goal is to contribute to the prevention of further pollution of the Black Sea.

The Bank adheres to the principles of the Washington Declaration on Environment and Sustainable Development of the World Federation of Development Financing Institutions. Furthermore, the Rules and Procedures for Environmental Appraisal will be based on the EU council Directives No. 85/337/EEC and 97/11/EC, as well as on similar procedures of the World Bank, EIB and EBRD. The Bank makes all necessary efforts to ensure that in projects financed directly or indirectly through financial intermediaries, it contributes to the implementation of multilateral environmental agreements, such as the Framework Convention on Climate Change, the Montreal Protocol and the Convention on Biological Diversity. International agreements, such as those concluded under the United Nations Commission for Europe, i.e. the Convention on Environmental Impact Assessment in a Transboundary Context and others, as well as national requirements are respected.

III.9 Special Funds

Given the limited resources of the Bank and the challenging development agenda facing most Member States, development and implementation of a policy to attract and utilize Special Funds are essential to the successful achievement of the mission of the Bank. This activity is deriving directly from the provisions of the Agreement Establishing the BSTDB. There exist four categories of Special Funds: (i) financing support for projects, (ii) financing of advisory services, (iii) preparation of studies, and (iv) support for special regional programs. The Bank has worked to develop a strategy for Special Funds, putting it within the context of overall trade and project finance operations and defining clearly the objectives. Contacts have been made with multi-lateral and bilateral development organizations, and the groundwork has been laid for establishment of Special Funds.

III.10 Activities beyond the BSEC Region

The conclusion of the Kosovo crisis was followed by a restructuring of the regional institutional environment, including the establishment of new regional political organizations and a marked increase in attention from governments, donors, and international financial institutions. Chief among these is the Stability Pact for South-eastern Europe, and BSTDB has participated in many of the conferences, roundtables and workshops that have taken place, since Member countries were affected by the economic, political, and environmental impact of the conflict. In addition, while neither the Kosovo region nor any of the republics of the former Yugoslavia are BSEC Members, the Bank has sought to cooperate with international institutions to facilitate trade and investment from Member state firms. Within the context of the Stability Pact, the activities examined include facilitating exports, guaranteeing investments from Member country firms, and participating in regional equity funds which promote small and medium enterprises in Kosovo. This represents a challenge with many facets, particularly for a new institution such as BSTDB, for while it is fully within the mandate of the Bank to be actively involved in regional activities, it must ensure that in doing so it promotes shareholder interests. This limits BSTDB to financing projects -- or the portions of projects -- which cover Member countries. However, since regional integration and promotion of economic cooperation are BSTDB's principal raisons d'etre, activities that move toward these goals may be in the interests of the shareholders, even if they involve participation in a broader regional context.

In addition, BSTDB involvement has sought to highlight the importance of ensuring that commitments made in the context of the Stability Pact are 'additional'- e.g. 'over and above' existing portfolios and not merely a re-allocation from one area to another. Some BSTDB Members are signatories to the Stability Pact, and therefore stand to gain directly from its programs; however, others are not, and it is important that balance is maintained, since significant developmental needs exist equally in places that do not happen to be situated in the spotlight.

Building the Bank: Administration and Human Resources in 1999

IV.1 Administration and communications

BSTDB operations were designed and established in 1999. Intensive studies were carried out, relating to the creation of an appropriate organizational and operational infrastructure for the Bank. The major achievements by area of responsibility have been as follows:

Recruitment

The year saw the expansion of the Bank's personnel from its original core of 13 to 39 persons, 85% of which are citizens of the Member States. Additional 33 positions were in the final stages of the recruitment process, mainly for international staff positions. The 1999 recruitment announcements attracted 3,556 applications and a large proportion of the applicants were interviewed. The recruitment process was conducted in a highly methodical and careful way to enable the Bank to hire highly qualified and professional staff.

Administrative Services and Purchasing

The year 1999 saw the ratification of the Headquarters Agreement by the Parliament of the host country and the successful application of the privileges granted to the Bank by its Establishing Agreement. A few minor status issues, that remain to be resolved, have been actively pursued and their finalization in the year 2000 is expected.

Administration-related policies were approved by the Board of Directors, and translated into concrete procedural guidelines that secured transparency and efficiency. The hiring of key personnel allowed the Bank to establish its internal allocation of tasks and duties related to the administrative support for front-line services.

A milestone achieved in the year was the relocation of the Bank's services from its temporary premises to its present four-story headquarters, while a 5th floor is currently under preparation to welcome the Bank's expansion in the year 2000. In the same connection, the Bank will continue to pursue actively identification of a suitable location for its permanent premises.

Public Relations and Publications

The organization of the BSTDB's inaugural ceremony was a major event of the year 1999. The event outlined in its symbolism the willingness of the Bank and that of its shareholders to achieve the institution's stated purpose and gathered international attention from other international financial institutions, governmental institutions, and the business community.

The Bank participated in major international events, and numerous business and economic conferences. In each case, it presented the improving environment for business activity in the greater Black Sea Region, and it emphasized the role it could play in supporting public and private sector projects.

The Bank published its first brochure, encompassing all policy related information necessary for the promotion of its activities to potential collaborators and customers. Furthermore, the Bank finalized its policy on Disclosure of Information and Confidentiality, with a clear view to incorporating in its operations the right mix of transparency and adherence to the standards of confidentiality appropriate for international financial institutions.

Information Technologies

A major achievement of the year was the acceleration of the process of equipping the Bank with the most appropriate information systems, culminating in the timely introduction of the most critical systems for the basic support of operations, including the Intranet and the SWIFT system. Furthermore, the Bank concluded the award of major contracts, such as the one for the Banking Applications Subsystem that will form the core of its management information system.

Board of Directors and Board of Governors Communications

Apart from the successful 1999 Annual Meeting of the Board of Governors in Kiev, the political decisions necessary for the establishment of the Bank's operations were taken in seven meetings of the Board of Directors.

During these meetings all the basic policies of the Bank were approved, including among others, the Business Plan 1999-2001, ten out of the eleven Country Strategies, the Financial Policies, the Portfolio Risk Management and Investment Policies, the Project and Trade Cycle Policy Documents, the Country Risk Rating System and the Guidelines for the Approval and Selection of Financial Intermediaries

IV.2 Human resources policy guidelines

The Bank aims to attract qualified professionals in specific areas of direct relevance to the Bank's needs. While there are no limitations on nationality, the majority of the staff is recruited from the Member States, and represents a broad mix of skills and backgrounds needed for the conduct of Bank operations.

Staff regulations take into account the specific nature of the Bank and the need to pay due regard to appropriate staff incentives. The Bank acts, at all times, with fairness and impartiality in its relations with staff members and practices diversity in staffing consistent with the nature and objectives of the Bank. Furthermore, the Bank:

- Establishes and maintains appropriate safeguards to respect and protect the personal privacy of staff members;
- Makes all reasonable efforts to ensure appropriate protection and safety for staff members in the performance of their duties;
- Provides staff members with reasonable security in their employment, consistent with the terms of their appointments, their satisfactory performance and conduct, and the efficient administration of the Bank;
- Takes such measures as may be necessary to protect the international character of the staff.

The Bank has developed and maintains appropriate compensation and personnel management policies, practices and incentives to help create an environment conducive to the high standards of performance required by the Bank in the interests of its members.

The Bank's recruitment policy is to attract staff members of high quality appropriate for the requirements of the position, under employment terms that are responsive both to the Bank's needs and the staff members' well being. To this end, the Bank gives paramount importance to securing the highest standards of professionalism, efficiency and technical competence in appointing staff members and, within that parameter, pays due regard to the importance of recruiting staff on as wide a geographical basis as possible. There is no discrimination against any person because of sex, nationality or creed, in the process of recruitment, assignment and promotion.

Compensation Policy

The Bank has designed a market oriented staff compensation policy, within the framework of the BSTDB's status as an international financial institution. In the second half of 1999, the Bank found itself needing to revise its remuneration package and to this end commissioned a study from OECD-IOS for the purpose of improving its competitive position vis-a-vis its comparators. This policy aims to meet the following objectives:

- To attract and retain high calibre employees;
- To take account of different levels of responsibilities;
- To be sufficiently flexible to respond rapidly to the market;
- To motivate, encourage and reward excellent performance.

Training

The BSTDB considers training to be a major means to sustain long-term success. The Bank strives to maintain a high level of training, so as to enable international mobility and career development. Any major additions to or changes in financial products or in the data-processing environment, and variations in market conditions of Member States, may require additional training. The Bank is establishing training programs with an approach to management development and team building, which allows the Bank as a whole, as well as individual employees, to address complex business challenges.

Financial management: Laying the foundations for the future

V.1 Financial Results

In 1999 the BSTDB achieved a higher net income than expected, mainly due to its lower operating expenses compared to those budgeted. This reflects the Bank's commitment to budget discipline and cost consciousness in response to evolving needs. The Bank posted net income for the year of US$ 4,039 thousand.

Key Figures for the Bank in year 1999
Expressed in Thousands of US Dollars

Total Revenues	8,898
General Administrative Expenses	4,889
Net Income	4,039
Paid up capital	178,649
Total Equity (subscribed)	1,372,510

Revenues

In its initial effective year of operation, the Bank's 1999 revenues came from interest earned on equity. The Bank became operational in June 1999 and therefore no revenues were recorded from banking operations. Total revenues for the Bank were US$ 8,898 thousand deriving from interest earned on deposits with other banks, mainly through EBRD as a trustee for the Bank, and marginally through major international commercial banks.

Expenses

General administrative expenses, including depreciation, for the year were US$ 4,889 thousand, which were US$ 3,383 thousand higher than in 1998. General administrative expenses consist of salaries and benefits, other administrative and depreciation expenses.

Salaries and benefits, in the amount of US$ 2,740 thousand, represented an increase of US$ 2,146 thousand over the previous year due to major increase in staff appointments that occurred during the year. This trend will continue in the year 2000 as the Bank further builds up operations, requiring additional professional staff to reach full operational capacity.

Other administrative expenses for 1999 were US$ 2,054 thousand, an increase of US$ 1,154 thousand over 1998.

Overall general administrative expenses were well within the 1999 Budget, reflecting the Bank's commitment to budget discipline and effective cost control.

Funding

Funding for the Bank came from the equity capital of its shareholders. The Bank did not initiate any borrowing activities.

Outlook for the year 2000

The BSTDB projects to continue being profitable in the year 2000. Since the financial position may deteriorate- as the Bank is sensitive to potential adverse and uncertain developments that may affect the quality of its portfolio- the Bank's priority for the year 2000 is to build up adequate levels of reserves and to take other necessary measures with a view to consolidating its financial viability.

V.2 Capital and Financial Status

Capital base

As specified in the Establishing Agreement, the BSTDB's initial authorized capital stock is one billion (1,000,000,000) Special Drawing Rights (SDR) divided into one million (1,000,000) shares having a par value of one thousand (1,000) SDR each. All participating Member States of the Bank have fully subscribed to their portion of the initial authorized capital stock. The subscribed capital is composed of:

- Ten per cent (10%) fully paid shares;
- Twenty per cent (20%) paid by promissory notes (in eight equal annual instalments, encashments starting from the year 1998);
- Seventy per cent (70%) callable shares.

The aggregate par value of the initial authorized fully paid shares is SDR 100 million and that of the capital paid by promissory notes is SDR 200 million. The Board of Governors will review the capital stock of the Bank at regular intervals, which are not to exceed 5 years.

As of 31 December 1999, one hundred and fifty million special drawing rights (SDRs) were due to be paid-up by the participating Member States, in accordance with the schedule laid down in the Establishing Agreement. This included the total portion of the subscribed capital of the ten per cent (10%) fully paid shares (SDR 100,000,000), as well as two instalments out of the total of eight annual equal instalments of the twenty per cent (20%) payable shares in promissory notes. The total initial authorized capital stock of the Bank of SDR 1,000,000,000 remained unchanged.

Financial documentation

Major policy and guideline documents have been prepared and approved for the operations of the Bank including: Financial Policies, Treasury Investment Authority, Accounting Policies, Portfolio Risk Management & Investment Policies, Country Risk Rating System, Guidelines for the Appraisal & Selection of Financial Intermediaries, and Rules & Regulations under Article 19.1(c), describing procedures of the Bank's maintenance of value for its share capital contributions.

Initially, the Bank outsourced specialized accounting services for the maintenance of its financial books and records. As of June 1999, the Bank introduced its own chart of accounts, procedures and internal controls, taking over internally the responsibility from the outsourced accounting services for all processing and maintenance of its financial books and records.

Correspondent relations

During the financial year 1999, the BSTDB entered into correspondent relations with major international financial institutions. As a result, at the end of the year the Bank had operational correspondent accounts opened in US Dollars, Euros, British Pounds, and Japanese Yen. The Bank's priority for the year 2000 is to continue to build up the correspondent relations' network as required by its lending and treasury operations.

Borrowings

The BSTDB will build-up its borrowing capacity to ensure that sufficient liquid funds are available so that the Bank is in a position to carry out its banking operation and abide by its liquidity policies. In addition, the Bank will seek to raise its profile within financial markets through intensive marketing towards major commercial banks, and it will take maximum advantage of co-financing opportunities with other International Financial Institutions, thus sharing in the high rating of these co-financiers.

Status

As an international financial institution, the Bank has preferred creditor status.

Rating

As a newly established institution, the Bank has not yet applied for a credit rating from any of the rating agencies. This remains a matter of operational priority, and the Bank intends to apply for such a rating as soon as it is feasible and practicable to do so. The main objective is to achieve an investment grade credit rating, so that the Bank can raise capital at lower cost, to the ultimate benefit of its shareholders and clients. Achievement of an investment grade credit rating will depend upon steadily building up a strong and credible asset portfolio, instituting prudent policies approved by the Bank's governing bodies and employing rigorous procedures for financial management. Other factors will contribute to this objective as well, including the preferred creditor status of the Bank and the strong commitment of its shareholders.

Disclosures

Through its reports and disclosures, the BSTDB follows the reporting conventions of other international financial institutions, in line with its policy to reflect best industry practice. The Accounting Policies adopted by the Bank are based on International Accounting Standards (IAS).

In accordance with Article 4 of the Establishing Agreement, the Bank's unit of account is SDR. The Bank's functional currency is the US$. The annual financial statements are presented both in US$ and SDR. For the purpose of the preparation of the financial statements the following year-end exchanged rates were used:

- 31 December 1999, 1 SDR = 1.37251 US$
- 31 December 1998, 1 SDR = 1.40479 US$

V.3 Principles of Financial Management

The BSTDB has developed and adopted a set of Financial Policies defining the framework of the Bank's financial management and the policy guidelines.

The BSTDB's financial management is based on (i) pursuing financial viability, (ii) following market and performance orientation in all its activities, (iii) working within a comprehensive risk management framework, and (iv) ensuring transparency and accountability at all levels and supporting effective corporate governance.

Limitations on the Use of the Bank's Capital

The BSTDB's Agreement places a number of institutional limitations on the use of the Bank's capital for its ordinary operations. Treasury investments, that is, management of the Bank's liquid assets, are considered auxiliary to the Bank's ordinary operations.

The total amount of outstanding loans, equity investments and guarantees made by the Bank in its ordinary operations shall not at any time exceed 150% of the total of the Bank's unimpaired subscribed capital, reserves and surpluses included in its ordinary capital resources, thus establishing a 1.5:1 gearing ratio. However, for considerations of prudency the Bank intends during its initial stages of operation to observe an operational gearing ratio limited to 1:1 of its paid-in capital, reserves and surpluses and 50% of the callable capital for the first three years of operations. The Bank also intends to follow in its operations capital adequacy requirements as provided by the Bank of International Settlements (BIS), Basle.

Reserves and Provisions

The BSTDB's provision policy ensures that the level of general provisions is determined by the credit-risk rating of individual loans and equity investments.

Risk provisions are made mainly on loans disbursed for both project and trade finance. In addition, the Bank pursues a policy of making specific provisions on a case-by-case basis, as required.

The Bank will maintain reserves and provisions consistent with its growing and regionally concentrated portfolio. The target to be achieved for total reserves, over time, is set at 10% of disbursed loans plus 25% of disbursed equity investments. The Bank's provisioning policy aims at rather early progress towards achieving this target, since a large proportion of operations are planned for the private sector, without any sovereign guarantee.

Credit Risk

The BSTDB is exposed to credit risk in both its ordinary operations and its Treasury activities. The majority of credit risk lies in the lending portfolio. The Bank manages all aspects of its credit risk exposure within a robust credit risk management framework, based on quantifying related risk exposures and properly assessing risk mitigants.

The Bank's exposure to various types of risk is monitored on an ongoing basis by the Credit Risk Department of the Bank. The Credit Risk Department assigns ratings to countries, financial institutions and individual projects, based on a variety of quantitative and qualitative methodologies thus determining product pricing, tenor of instruments/investments, as well as the frequency of reviews and the level of provisions.

Portfolio Diversification

The BSTDB seeks to maintain reasonable diversification in its credit portfolio to spread project and borrower credit risk.

Risk Mitigation

The BSTDB will normally require its operations to benefit from some form of security or risk sharing in order to mitigate the credit risks involved. When the Bank lends to public or private sector borrowers, it will normally require certain guarantees and, in all cases, will ensure that the parties involved share risks in a reasonable manner.

Treasury operations

Given the relatively high credit risk profile on the lending side, resulting largely from the region of operations, the Bank aims to minimize its exposure to other risks. Hence, Treasury operations are to be performed within conservative risk parameters.

Risk Management

Activities of the Treasury are regulated within a comprehensive policy framework provided by the Financial Policies, the Treasury Investment Authority, the Treasury Investment Guidelines and by Operational Procedures issued by the appropriate level of authority. These ensure that exposures to foreign exchange risk, liquidity risk, interest rate risk and other market risks are managed effectively within closely monitored limits and criteria adopted by the Bank for risk management.

Foreign Exchange and Interest Rate Risk

As a matter of policy, the Bank will strive to maintain a matched foreign exchange (FX) book and immunize its balance sheet to the extent feasible from the effects of interest rate movements. The guiding principles provide that:

- the Bank's FX and interest position is monitored daily;
- the Bank is not taking significant discretionary own account FX or interest rate positions (e.g.: a position which is not practical to be squared at a favourable market rate).

Pricing policy

The BSTDB seeks to recover all costs of intermediation (including general administrative expenses, borrowing costs and provisions against expected losses) and to earn an appropriate return on its capital. The pricing of products of all types will be in line with the pricing of assets with similar risk profiles by other financial institutions and thus (to the extent such comparisons can be made and/or a market exists) reflect the market's perception of the risks involved.

Financial planning

The BSTDB is committed to budgetary discipline within a framework of budgetary policies that aim to maintain a balance between an appropriate allocation of resources and operational objectives. Review processes involve a Bank-wide assessment of the program objectives for the year, its costs, and budgetary requirements, taking into consideration both external and internal developments.

Operational risk

Operational Risk brings together all aspects of risk related exposure other than those falling within the scope of the definition of market and credit risk.

Control of operational risk within the Bank will rely heavily on the fundamental framework of sound banking practice and a robust financial control framework, with appropriate checks and balances and segregation of duties, as established by related processes and procedures. In addition, Internal and External Auditors will regularly audit the Bank.

Reporting

The BSTDB's corporate governance structure is supported by appropriate financial and management reporting. With respect to external financial reporting, the Bank presents financial statements in its Quarterly Summary Statement Financial Reviews and in the Annual Report, prepared in accordance with

International Accounting Standards. In accordance with Article 35 of the Establishing Agreement, these reports are transmitted to the Governments of the Member States (Annual Report only), members of the Board of Governors, and Directors and the BSEC Permanent International Secretariat. The Annual Report 1999 is the first annual report published following the commencement of operations of the BSTDB.

In its financial reporting, the Bank aims to provide appropriate information on risk and performance. Industry best practice will guide the evolving disclosure practice both in public financial reports and management information reporting, with the ultimate aim of enhancing accountability throughout the organisation.

V.4 Financial Statements, expressed in US Dollars

PROFIT AND LOSS STATEMENT

For the year ended 31 December 1999

Expressed in thousands of United States Dollars	Note	Year to 31 December 1999	Year to 31 December 1998
INTEREST AND SIMILAR INCOME			
Interest on Deposits with Banks	2	8,898	10,094
OPERATING INCOME		8,898	10,094
GENERAL ADMINISTRATIVE EXPENSES	4	4,889	1,506
EXTRAORDINARY INCOME / (LOSS)	5	30	(288)
NET INCOME FOR THE YEAR		4,039	8,300

The accompanying notes are an integral part of these financial statements

BALANCE SHEET

For the year ended 31 December 1999

Expressed in thousands of United States Dollars	Note	Year to 31 December 1999	Year to 31 December 1998
ASSETS			
Cash and Bank Balances		370	172
Placements with Financial Institutions	6	180,308	124,652
Other Deposits	7	3,617	6,029
Total Deposits		184,295	130,853
Interest, Fees and Other Receivables	7	1,971	238
Share Capital Replenishment Portion not Received	7	5,648	3,453
Share Capital Due but not Received	6	5,378	12,556
Share Capital Short-term Subscription Receivable	6	21,849	35,120
Paid-in Share Capital		32,875	51,129
Property, Technology and Office Equipment	8	649	132
Less Accumulated Depreciation		(107)	(12)
Net Property, Technology and Office Equipment		542	120
Other Assets	9	80	58
TOTAL ASSETS		219,763	182,398
LIABILITIES			
Payables and Accrued Expenses	10	187	82
MEMBERS' EQUITY			
Subscribed Share Capital	6	1,372,510	1,404,790
Less Callable Share Capital	6	(960,757)	(983,353)
Less Payable Share Capital	6	(205,877)	(245,838)
Cumulative Translation Adjustment	6	(602)	(3,460)
Advance against Future Call	6	1,963	1,877
Paid-in Share Capital		207,237	174,016
Net Income for the Year		4,039	8,300
Retained Earnings		8,300	0
TOTAL LIABILITIES & MEMBERS' EQUITY		219,763	182,398

The accompanying notes are an integral part of these financial statements

STATEMENT OF CHANGES IN MEMBERS' EQUITY

For the year ended 31 December 1999

Expressed in thousands of United States Dollars	Subscribed Share Capital	Callable Share Capital	Payable Share Capital	Surplus	Total Members' Equity
Paid-in Share Capital	1,404,790	(983,353)	(245,836)		175,599
Cumulative Translation Adjustment			(3,460)		(3,460)
Advance against Future Call			1,877		1,877
Net Income for the Year				8,300	8,300
At 31 December 1998	**1,404,790**	**(983,353)**	**(247,421)**	**8,300**	**182,316**
Exchange Rate difference on conversion of Share Capital	(32,280)	22,596	9,684		- 0
Paid-in Share capital			30,278		30,278
Cumulative Translation Adjustment			2,858		2,858
Advance against Future Call			85		85
Net Income for the Year				4,039	4,039
At 31 December 1999	**1,372,510**	**(960,757)**	**(204,516)**	**12,339**	**219,576**

The accompanying notes are an integral part of these financial statements

STATEMENT OF CASH FLOWS

For the year ended 31 December 1999

Expressed in thousands of United States Dollars	Note	Year to 31 December 1999	Year to 31 December 1998
CASH FLOWS FROM OPERATING ACTIVITIES			
Net Income for the Year		4,039	8,300
Depreciation		95	12
Total Adjustments		95	12
Interest, Fees and Other Receivables		(1,733)	(238)
Other Assets	9	(22)	(58)
Increase in Operating Assets		(1,755)	(296)
Payables and Accrued Expenses	10	105	82
Increase in Operating Liabilities		105	82
Net Cash Flows from Operating Activities		2,484	8,098
CASH FLOWS FROM INVESTING ACTIVITIES			
Purchase of Technology and Office Equipment	8	(517)	(132)
Net Cash Used in Investing Activities		(517)	(132)
CASH FLOWS FROM FINANCING ACTIVITIES			
Increase in Share Capital Payable Due	6	33,221	174,016
Increase in Share Capital Portion not Received	7	(2,195)	(3,453)
Decrease in Share Capital Due but not Received	6	7,178	(12,556)
Decrease in Share Capital Short-term Receivable	6	13,271	(35,120)
Paid-in Share Capital Received		51,475	122,887
Net Cash Provided by Financing Activities		51,475	122,887
Net Increase / (Decrease) in Cash and Cash Equivalents		53,442	130,853
CASH AND CASH EQUIVALENTS AT BEGINNING OF YEAR		130,853	0
CASH AND CASH EQUIVALENTS AT END OF YEAR		184,295	130,853

The accompanying notes are an integral part of these financial statements

CAPITAL SUBSCRIPTION AND VOTING POWERS

For the year ended 31 December 1999

Members	Shares	Total Suscribed	Callable	Payable	Paid	Voting Power
Expressed in thousands of United States Dollars		USD 000	USD 000	USD 000	USD 000	
Republic of Albania	20,000	27,450	19,215	8,235	1,405	0.8%
Republic of Armenia	20,000	27,450	19,215	8,235	2,617	1.5%
Republic of Azerbaijan	20,000	27,450	19,215	8,235	213	0.1%
Rupbulic of Bulgaria	135,000	185,289	129,702	55,587	18,529	10.4%
Republic of Georgia	20,000	27,450	19,215	8,235	2,693	1.5%
Hellenic Republic	165,000	226,464	158,525	67,939	33,970	19.0%
Republic of Moldova	20,000	27,450	19,215	8,235	1,419	0.8%
Romania	135,000	185,289	129,702	55,587	27,793	15.6%
Russian Federation	165,000	226,464	158,525	67,939	28,326	15.9%
Republic of Turkey	165,000	226,464	158,525	67,939	33,970	19.0%
Ukraine	135,000	185,289	129,702	55,587	27,714	15.5%
	1,000,000	1,372,510	960,757	411,753	178,649	100.0%

V.5 Notes to the Financial Statements

1. Establishment of the Bank

1.1 Agreement Establishing the Bank

The Black Sea Trade and Development Bank ("the Bank"), whose headquarters office is located in the city of Thessaloniki of the Hellenic Republic, is an international financial organization under the Agreement Establishing the Bank dated 30 June 1994 ("the Agreement"). At 31 December 1999 the Bank's shareholders comprised of 11 countries: Albania, Armenia, Azerbaijan, Bulgaria, Georgia, Greece, Moldova, Romania, Russian Federation, Turkey and Ukraine.

In accordance with Article 61 of the Agreement, the Bank was established and the Agreement entered into force on 24 January 1997.

1.2 Headquarters Agreement

The status, privileges and immunities of the BSTDB and persons connected therewith in the Hellenic Republic are defined in the Headquarters Agreement between the Government of the Hellenic Republic and the Bank ("Headquarters Agreement"). The Headquarters Agreement was signed on 22 October 1998. The Bank commenced operations on 1 June 1999.

2. Significant accounting policies

The financial statements have been prepared in accordance with the Bank's Accounting Policies, which fully comply with International Accounting Standards (IAS). Whenever IAS will not provide sufficient guidance, the overall principles of the European Communities Council Directive on the annual accounts and consolidated accounts of banks and other financial institutions shall be used by the Bank. The Bank's balance sheet is stated in accordance with the historical cost convention.

2.1 Foreign Currencies

The Bank maintains its books, records and reports in its functional currency, which is the US Dollar (US$). For management reporting purposes the Bank also presents its financial statements in Special Drawing Rights (SDRs), which is the currency in which the share capital is denominated.

Foreign currency transactions are recorded on initial recognition in US$ by applying to the foreign currency amount the exchange rate between the functional currency and the foreign currency at the date of the transaction.

The basis of conversion of the US$ financial statements into SDR for monetary assets and liabilities, are translated into SDR at closing rates as at 31 December 1999. Non-monetary items are expressed in SDR at the exchange rates prevailing at the time of the transaction. Revenue and expense items are translated into SDR at the prevailing rate of the beginning of the month in which they occurred.

Exchange gains or losses arising from the translation of assets, liabilities and transaction during the period are taken to the profit and loss account. The translation gains or losses on share capital subscription received are credited or debited to the "Cumulative Translation Adjustment" (Note 6).

2.2. Property, Technology and Office Equipment

Property, technology and office equipment are stated at cost, less accumulated depreciation. Depreciation is provided so as to write-off the cost of each asset to their residual values on a straight line basis over their estimated useful lives, except for leasehold buildings and improvements which are depreciated over the remaining term of the lease, where this period is shorter than their estimated useful lives.

The estimated useful lives of property, technology and office equipment are as follows:

Furniture, furnishings and appliances	5 years
Personnel computers, related software and peripherals	3 years
Office and telecommunication equipment	5 years

2.3 Interest

Interest income is recorded on an accrual basis.

2.4 Pension Cost and Termination Benefits

Current service costs in respect of both defined benefit and contribution schemes (IKA) are recognized as an expense in the current period.

The Bank has no termination policy in the Guidelines for Benefits System. Employees eligible to this benefit are those subject to a probationary period. The Bank reserves the right at any time during the probationary period to terminate the appointment and will make a termination payment equivalent to three months' basic salary.

2.5. Taxation

In accordance with Article 52 of the Establishing Agreement, the Bank, its assets, property, income and its operations and transactions are exempt from all taxation and all customs duties. The Bank is also exempt from any obligation for payment, withholding or collection of any tax or duty. No tax shall be levied on salaries or emoluments paid by the Bank to employees. Said tax exemptions are enforced by the Headquarters Agreement of Article 12, and have been implemented by the Greek Government by virtue of the ratification of Law 2707/No.78/13.04.1999.

3. Co-financing

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

The Bank's first lending operation was approved in December 1999, for the sum of US$ 12 million, a loan to Ukraine to finance the construction of a natural gas station in cooperation with EBRD. The project is expected to increase the capacity of the pipeline that links Russia with Turkey through Ukraine, Moldova, Romania and Bulgaria. As at 31 December 1999 no disbursement had been made for the above-approved amount.

4. General administrative expenses

General administrative expenses in the accompanying profit and loss statements are analysed as follows:

Expressed in thousands of United States Dollars	**1999**	**1998**
Salaries and benefits	2,740	594
Other administrative expenses	2,054	900
Depreciation expenses	95	12
General administrative expenses	4,889	1,506

5. Extraordinary income and loss

Extraordinary income or loss in the accompanying profit and loss statements consists primarily of exchange differences.

6. Subscribed share capital

In accordance with article 4 of the Agreement, the initial authorized capital stock of the Bank shall be one billion SDR divided into one million shares having a par value of one thousand SDR each. All the participating Member States have fully subscribed to their portion of the initial authorized capital stock in accordance with Article 5 of the Agreement.

In accordance with paragraph 2 under Article 6 of the Agreement, payment for the portion of the shares referred to as [fully paid 10%] shall be made by each Member State within 60 days after the date on which it becomes a member of the Bank. At year-end 1999 five Member States (Albania, Armenia, Azerbaijan, Georgia and Moldova) had not deposited their total share capital amount of the initial fully paid shares. The balance of the share capital due at 31 December 1999 was US$ 5,378 thousand (SDR 3,918 thousand) and at 31 December 1998 was US$ 12,556 thousand (SDR 8,937 thousand).

In accordance with paragraph 3 under Article 6 of the Agreement, payment for the portion of the shares [subscribed 20%] shall be made by each Member by promissory notes or other obligation issued by such Member. Such promissory notes shall be paid to the Bank in eight equal successive annual instalments. As of 31 December 1999, three Member States (Greece, Romania and Turkey) had issued promissory notes. Furthermore, two instalments, out of the total of eight annual instalments, at year-end 1999 were due to the Bank and eight Member States (except Greece, Romania and Turkey) had not fully paid. The balance of the short-term subscription receivable at 31 December 1999 was US$ 21,849 thousand (SDR 15,919 thousand) and at 31 December 1998 was US$ 35,120 thousand (SDR 25,000 thousand).

The subscribed share capital is analysed as follows:

	1999		**1998**	
	SDR 000	**US$ 000**	**SDR 000**	**US$ 000**
Subscribed share capital	1,000,000	1,372,510	1,000,000	1,404,790
Less callable shares	700,000	960,757	700,000	983,353
Less payable shares	150,000	205,877	175,000	245,838
Called-up share capit	150,000	205,876	125,000	175,599
Cumulative translation adjustment	---	(602)	---	(3,460)
Advance against future calls	---	1,963	---	1,877
Paid-in share capital	150,000	207,237	125,000	174,016

The cumulative translation adjustment is the exchange gain or loss in order to duly reflect fluctuations of the US$ values of the Member States equity, which is denominated in SDR equivalent amounts. These fluctuations do not affect shareholders' stand vis-a-vis the Bank.

The major part (US$ 156,154 thousand) of the paid-in share capital contributed by the Member States is deposited with EBRD.

The capital subscription status and voting power of each Member State is analysed as follows:

Member	Shares	Total Subscribed US$ (000)	Callable US$ (000)	Payable US$ (000)	Paid US$ (000)	Voting Power
Rep. of Albania	20,000	27,450	19,215	8,235	1,405	0.8%
Rep. of Armenia	20,000	27,450	19,215	8,235	2,617	1.5%
Rep. of Azerbaijan	20,000	27,450	19,215	8,235	213	0.1%
Rep. of Bulgaria	135,000	185,290	129,703	55,587	18,529	10.4%
Georgia	20,000	27,450	19,215	8,235	2,693	1.5%
Hellenic Rep.	165,000	226,464	158,525	67,939	33,970	19.0%
Rep. of Moldova	20,000	27,450	19,215	8,235	1,419	0.8%
Romania	135,000	185,290	129,703	55,587	27,793	15.6%
Russian Federation	165,000	226,464	158,525	67,939	28,326	15.8%
Rep. of Turkey	165,000	226,464	158,525	67,939	33,970	19.0%
Ukraine	135,000	185,290	129,703	55,587	27,714	15.5%
Total	1,000,000	1,372,510	960,757	411,753	178,649	100.0%

7. Other deposits and share capital replenishment portion not received

In accordance with Article 6 of the Agreement each Member State shall be free to select the currency or currencies and the proportion thereof, in which the payment will be made. The portion of the national currency of the respective Member State in each payment shall not exceed fifty (50%) per cent of the amount due for such payment.

Romania exercised this option and its 50% contribution to the ten per cent fully paid share capital equivalent to SDR 6,750 thousand or ROL 66,021,750 thousand was deposited in a local currency account with the Central Bank of Romania. The value of this contribution converted in US$ at 31 December 1998 was US$ 6,029 thousand while at 31 December 1999 was US$ 3,617 thousand.

At 31 December 1999 an amount of US$ 5,648 thousand is due from Romania in order to replenish the value of its contribution. In addition, in accordance with the Agreement, Romania has to pay interest to the Bank on the equivalent SDR balance per annum, of SDR 6,750 thousand for the contribution held in local currency at its Central Bank. The interest due was US$ 970 thousand and is included in "Interest, Fees and Other Receivables" in the accompanying 31 December 1999 balance sheet.

The replenishment portion and the interest amounts are expected to be paid to the Bank in accordance with the Rules and Regulations under article 19.1(c) of the Agreement approved by the Board of Directors.

Expressed in thousands of United States Dollars	**1999**	**1998**
Value of share capital in central bank (blocked account)	3,617	6,029

Amount due for replenishment of share capital	5,648	3,453
Total share capital contribution	9,265	9,482

8. Property, technology and office equipment

Property, technology and office equipment in the accompanying balance sheets are analysed as follows:

Expressed in thousands of United States Dollars	**1999**	**Additions**	**1998**
Buildings (leasehold improvements)	15	15	---
Furniture and furnishings	253	214	39
Office equipment	370	277	93
Software	11	11	---
Total property, technology and equipment	649	517	132
Less accumulated depreciation	(107)	(95)	(12)
Net book value	542	422	120

9. Other assets

Other assets in the accompanying balance sheets are analysed as follows:

Expressed in thousands of United States Dollars	**1999**	**1998**
Guarantee deposits	26	1
Advances for travel, salary and other	35	57
Prepaid expenses	19	---
Total other assets	80	58

10. Payables and accrued expenses

Payables and accrued expenses in the accompanying balance sheets are analysed as follows:

Expressed in thousands of United States Dollars	**1999**	**1998**
Advances to officers	---	6
Social security	6	---
Checks, payroll and suppliers payable	155	3
Other accrued expenses	26	73
Total payables and accrued expenses	187	82

11. Commitments and other contingencies

The Bank has entered into a lease for its office facilities commencing on 1 November 1998, and for a period of three years. On 1 December 1999, an additional floor was leased for a period of three years in the same building to accommodate the new staff joining the Bank.

The related future commitments with respect to the above lease agreements are as follows:

for year 2000	US$ 356,635
for year 2001	US$ 313,960
for year 2002	US$ 92,210

The above amounts have been converted into US$ from Greek Drachmas based on 31 December 1999 exchange rates.

V.6 Financial Statements, expressed in SDR

PROFIT AND LOSS STATEMENT

For the year ended 31 December 1999

Expressed in thousands of Special Drawing Rights	Year to 31 December 1999	Year to 31 December 1998
INTEREST AND SIMILAR INCOME		
Interest on Deposits with Banks	6,556	7,473
OPERATING INCOME	6,556	7,473
GENERAL ADMINISTRATIVE EXPENSES	3,582	1,099
EXTRAORDINARY INCOME / (LOSS)	22	(207)
NET INCOME FOR THE YEAR	2,996	6,167

BALANCE SHEET

For the year ended 31 December 1999

Expressed in thousands of Special Drawing Rights	Year to 31 December 1999	Year to 31 December 1998
ASSETS		
Cash and Bank Balances	270	122
Placements with Financial Institutions	131,371	88,734
Other Deposits	2,635	4,292
Total Deposits	134,276	93,148
Interest, Fees and Other Receivables	1,436	169
Share Capital Replenishment Portion not Received	4,115	2,458
Share Capital Due but not Received	3,918	8,938
Share Capital Short-term Subscription Receivable	15,919	25,000
Paid-in Share Capital	23,952	36,396
Property, Technology and Office Equipment	473	94
Less Accumulated Depreciation	(78)	(9)
Net Property, Technology and Office Equipment	395	85
Other Assets	58	41
TOTAL ASSETS	**160,117**	**129,839**
LIABILITIES		
Payables and Accrued Expenses	136	56
MEMBERS' EQUITY		
Subscribed Share Capital	1,000,000	1,000,000
Less Callable Share Capital	(700,000)	(700,000)
Less Payable Share Capital	(150,000)	(175,000)
Cumulative Translation Adjustment	(612)	(2,722)
Advance against Future Call	1,430	1,336
Paid-in Share Capital	150,818	123,614
Net Income for the Year	2,996	6,167
Retained Earnings	6,167	0
TOTAL LIABILITIES & MEMBERS' EQUITY	**160,117**	**129,839**

STATEMENT OF CHANGES IN MEMBERS' EQUITY

For the year ended 31 December 1999

Expressed in thousands of Special Drawing Rights	Subscribed Share Capital	Callable Share Capital	Payable Share Capital	Surplus	Total Members' Equity
Paid-in Share Capital	1,000,000	(700,000)	(175,000)		125,000
Cumulative Translation Adjustment			(2,722)		(2,722)
Advance against Future Call			1,336		1,336
Net Income for the Year				6,167	6,167
At 31 December 1998	**1,000,000**	**(700,000)**	**(176,386)**	**6,167**	**129,781**
Exchange Rate difference on conversion of Share Capital					0
Paid-in Share capital			25,000		25,000
Cumulative Translation Adjustment			2,110		2,110
Advance against Future Call			94		94
Net Income for the Year				2,996	2,996
At 31 December 1999	**1,000,000**	**(700,000)**	**(149,182)**	**9,163**	**159,981**

STATEMENT OF CASH FLOWS

For the year ended 31 December 1999

Expressed in thousands of Special Drawing Rights	Year to 31 December 1999	Year to 31 December 1998
CASH FLOWS FROM OPERATING ACTIVITIES		
Net Income for the Year	2,996	6,167
Depreciation	69	9
Total Adjustments	69	9
Interest, Fees and Other Receivables	(1,267)	(169)
Other Assets	(17)	(41)
Increase in Operating Assets	(1,284)	(210)
Payables and Accrued Expenses	78	56
Increase in Operating Liabilities	78	56
Net Cash Flows from Operating Activities	**1,859**	**6,024**
CASH FLOWS FROM INVESTING ACTIVITIES		
Purchase of Technology and Office Equipment	(379)	(94)
Net Cash Used in Investing Activities	**(379)**	**(94)**
CASH FLOWS FROM FINANCING ACTIVITIES		
Increase in Share Capital Payable Due	27,204	123,614
Increase in Share Capital Portion not Received	(1,657)	(2,458)
Decrease in Share Capital Due but not Received	5,020	(8,938)
Decrease in Share Capital Short-term Receivable	9,081	(25,000)
Paid-in Share Capital Received	39,648	87,218
Net Cash Provided by Financing Activities	**39,648**	**87,218**
Net Increase / (Decrease) in Cash and Cash Equivalents	**41,128**	**93,148**
CASH AND CASH EQUIVALENTS AT BEGINNING OF YEAR	**93,148**	**0**
CASH AND CASH EQUIVALENTS AT END OF YEAR	**134,276**	**93,148**

CAPITAL SUBSCRIPTION AND VOTING POWERS

For the year ended 31 December 1999

Members	Shares	Total Suscribed	Callable	Payable	Paid	Voting Power
Expressed in thousands of Special Drawing Rights		SDR 000	SDR 000	SDR 000	SDR 000	
Republic of Albania	20,000	20,000	14,000	6,000	1,024	0.8%
Republic of Armenia	20,000	20,000	14,000	6,000	1,907	1.5%
Republic of Azerbaijan	20,000	20,000	14,000	6,000	155	0.1%
Rupbulic of Bulgaria	135,000	135,000	94,500	40,500	13,500	10.4%
Republic of Georgia	20,000	20,000	14,000	6,000	1,962	1.5%
Hellenic Republic	165,000	165,000	115,500	49,500	24,750	19.0%
Republic of Moldova	20,000	20,000	14,000	6,000	1,034	0.8%
Romania	135,000	135,000	94,500	40,500	20,250	15.6%
Russian Federation	165,000	165,000	115,500	49,500	20,638	15.9%
Republic of Turkey	165,000	165,000	115,500	49,500	24,750	19.0%
Ukraine	135,000	135,000	94,500	40,500	20,193	15.5%
	1,000,000	**1,000,000**	**700,000**	**300,000**	**130,163**	**100.0%**

Report of the External Auditors

ARTHUR ANDERSEN

To the Board of Governors of the
Black Sea Trade and Development Bank

We have audited the accompanying balance sheet of the Black Sea Trade and Development Bank (hereinafter called the Bank) as of 31 December 1999 and the related profit and loss statement and statements of changes in members' equity and cash flows for the year then ended. These financial statements are the responsibility of the Bank's management. Our responsibility is to express an opinion on these financial statements based on our audit. The financial statements of the Bank as of 31 December 1998, were audited by another auditor whose report dated 31 March 1999, included the following qualification: "We have not received direct confirmation of the initial contribution of Albania and Moldova. Because the Bank was not in operation at the time and hence no detailed records were maintained, we were unable to apply alternative procedures in order to determine the exact Special Drawing Rights value of these contributions."

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

In connection with the qualification of prior year (see above paragraph one), it should be noted that, in this year's audit, we were able to verify the contributions of all member states as at 31 December 1999.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Bank as of 31 December 1999 and of the results of its operations for the year then ended, in accordance with International Accounting Standards and the overall principles of the European Community's Council Directive on the Annual Accounts and Consolidated Accounts of Banks and Other Financial Institutions.

Athens, Greece,
11 February 2000

Arthur Andersen

Composition of the Board of Governors and the Board of Directors

The Board of Governors

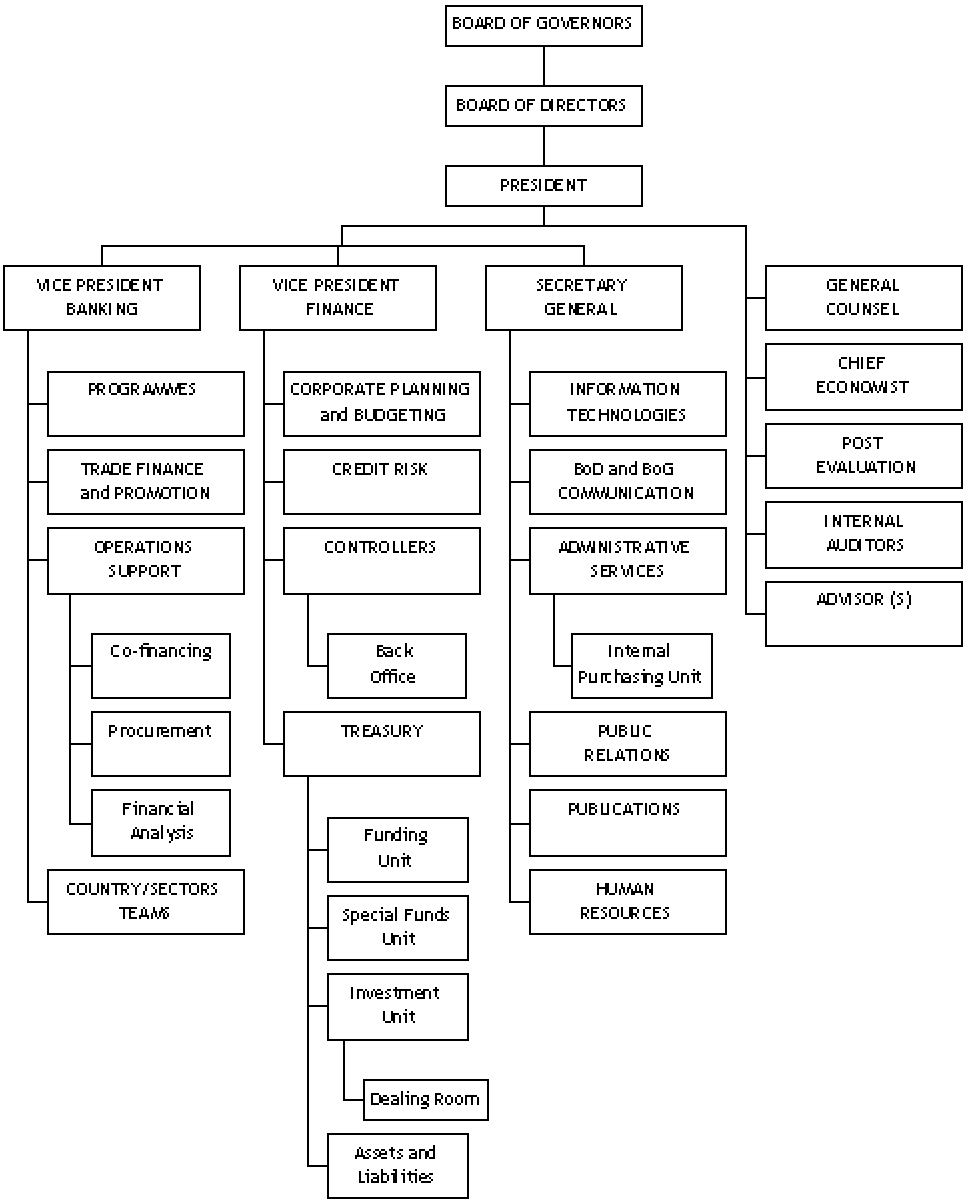
ARMENIA	**Mr. Levon BARKUDARYAN** Minister of Finance	**Mr. Gagik ARZUMANYAN** Deputy Ministerof Finance
BULGARIA	**Mr. Svetoslav GAVRIISKY** Governor Bulgarian National Bank	**Mr. Dimitar Borissor RADEV** Deputy Minister Ministry of Finance
HELLENIC REPUBLIC	**Mr. Nikolaos KARAMOORIS** Special advisor Ministry of Foreign Affairs	**Mr. Giannis PAPANIKOLAOU** Deputy Governor National Bank of Greece
ROMANIA	**Mr. Decebal Traian REMES** Minister of Finance	**Mr. Mircea Ionut COSTEA** Deputy Minister of Finance
TURKEY	**Mr. Selcuk DEMIRALP** Undersecretary of Treasury Ministry of State	**Mr. Ferhat EMIL** Deputy Undersecretary of Treasury

The Board of Directors

MEMBER STATES	DIRECTORS	ALTERNATE DIRECTORS
ALBANIA	**Mr. Marian GJERMENI** Director of Monetary Operations Dept Bank of Albania	
ARMENIA	**Mr. Arthur JAVADYAN** Board Member - Central Bank of Armenia	
AZERBAIJAN	**Mr. Samir SHARIFOV** Director – FX & Foreign Relts Dept National Bank of Azerbaijan	**Mr. Adalet N. ALIYEV** Division Chief Foreign Economic Relts Department, Ministry of Finance
BULGARIA	**Mr. Roumen AVRAMOV** Member of the Managing Board Bulgarian National Bank	**Ms. Nina STAVREVA** Head of State Treasury & Debt Dept. Ministry of Finance
GEORGIA	**Mr. David APTSIAURI** Director of Int. Economic Relts Ministry of Foreign Affairs	**Mr. Georgi CHIKAVA** Head of Currency Regulation Division National Bank of Georgia
HELLENIC REPUBLIC	**Mr. Stefanos AVGOULEAS** Head of Dept for Balkan States & BSEC General Secretariat for Int. Econ. Relts – Ministry of Nat. Economy	**Ms. Charalambia LOMBOTESSI** Secretary General – International Economic Relts, Ministry of National Economy
MOLDOVA	**Ms. Lidia GRACHILA** Head of International Financial Dept. Ministry of Finance	**Mr. Fiodor CHIRIAC** Economist Coordinator, International Financial Dept. Ministry of Finance
ROMANIA	**Ms. Valentina SICLOVAN** Deputy Director General Ministry of Finance	**Ms. Adriana MARINESCU** Director – International Relts & European Integration Dept. National Bank of Romania
RUSSIAN FEDERATION	**Mr. Ivan I. SERGEEV** Deputy Minister of Foreign Affairs	Mr. A.S. CHERNYSHOV Deputy Minister of Trade
TURKEY	**Mr. Aydin KARAOZ** Director General of Foreign Economic Relts Undersecretariat of Treasury	**Mr. Umit GONULAL** Deputy Director General of Foreign Economic Relations Undersecretariat of Treasury
UKRAINE	**Mr. Oleg RYBACHUK** Director - International Department	**Mr. Serhiy KRUHLYK** Deputy Director - International Dept National Bank of Ukraine

	National Bank of Ukraine	

Organisation structure of the Black Sea Trade and Development Bank



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General Counsel's Office	Daud Ilyas
Office of the Chief Economist	Ahmet Imre
Office of the Internal Auditor	Zenon Hadjiantonoglou
Post Evaluation Office	Todor Dimitrov

Banking Division	
Programmes	Panayotis Gavras Ghinea Arminio Iorga
Country/ Sector Teams	
Countries Greece, Ukraine, Armenia, Georgia Russia, Bulgaria, Azerbaijan Albania, Romania, Turkey, Moldova	 Umberto Del Panta Orhan Aytemiz Gueorgui Horozov
Sector Energy, Natural Resources	 Konstantin Limitovsky
Trade Finance and Promotion	Steven Beck Nejdet Sarizosen
Operations Support	Spiridon Michalitsianos

Finance Division	
Corporate Planning & Budgeting	Nicolas Papavramides
Credit Risk	George Pahinis
Treasury	Nikos Panteli
Controllers	Victoria Voytsitska

Division of the Secretary General	
Human Resources	Neslisah Aytug
Administrative Services	Kostis Zevgaridis
Information Technologies	Nikolay Markov
BoD & BoG Communications	Robert de Bruin
Public Relations	Valery Aksenov
Publications	Ralitsa Lalova

(as of March 2000)