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The European Bank for Reconstruction and Development: Legal and Policy Issues

John Linarelli*

INTRODUCTION

On May 29, 1990, in Paris, France, representatives of forty nations, the European Community (EC) and the European Investment Bank signed the Agreement Establishing the European Bank for Reconstruction and Development. The purpose of the Bank is to promote the development and reconstruction of the countries of Central and Eastern Europe. The Bank was conceived by President Francois Mitterrand of France and initially proposed by him in October 1989. Its establishment was agreed upon in only seven short months. The Agreement came into effect in March 1991 and the Bank began operations in April 1991. It has its head-

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1 Agreement Establishing the European Bank for Reconstruction and Development, May 29, 1990, 29 I.L.M. 1077 (1990) [hereinafter Agreement]. The European Bank for Reconstruction and Development shall hereinafter be referred to as the “EBRD” or the “Bank.”
2 As of April 1994, the Bank operates in the following countries: Albania, Armenia, Azerbaijan, Belarus, Bulgaria, Croatia, Czech Republic, Estonia, Former Yugoslav Republic of Macedonia, Georgia, Hungary, Kazakhstan, Kyrgyzstan, Latvia, Lithuania, Moldova, Poland, Romania, Russian Federation, Slovak Republic, Slovenia, Tajikistan, Turkmenistan, Ukraine and Uzbekistan. EUROPEAN BANK FOR RECONSTRUCTION AND DEVELOPMENT, FINANCING WITH THE EBRD 2 (1994) [hereinafter FINANCING WITH THE EBRD].
4 Easton & Rorer, supra note 3, at 527; EUROPEAN BANK FOR RECONSTRUCTION AND DEVELOPMENT, 1991 ANNUAL REPORT 9 (1992) (“The idea of the Bank was first conceived in October 1989, before the Berlin Wall came down; it was inaugurated in April 1991 before the Moscow coup; and, in a matter of months, it has become fully operational. It has a staff of 361
quarters in London, although both of its presidents have been
French. The formation of the Bank has been hailed as remarkable. It has
been described as “the first post cold war institution,” and the “first
institution of the new world order.” The majority of the Bank’s
shareholders are the states that comprise the European Union (EU),
although the EC itself and the European Investment Bank are also
shareholders. The United States is the largest single shareholder in
the Bank, and played an influential role in crafting key provisions
of the Articles of Agreement for the Bank.

The Bank is European in character, with an American influence. It
was formed at a time when there was an absence of one or a few
dominant nation-states. As explained by one scholar of international
relations:

EBRD extends the scale and scope of cooperation among
the Western powers to encompass a new geographic re­
gion. It is doing this during a period of rapid international
change and in the absence of hegemonic concentration of
power; and it is doing this according to a set of ideas and
standards of legitimacy that derive principally from a net­
work of international institutions in Europe.

The Bank is a unique multilateral development institution. Its
charter is based on political conditionality, a concept forbidden to
the World Bank. The very first article of the Articles of Agreement

close to 400 from almost all of its member countries.”). The Bank got off to a slow start, in
that its loan activities initially were relatively low. The Bank attributed this to the restrictions
in its Articles of Agreement and the lack of appropriate private sector projects in Central and
Eastern Europe. See Andre Newburg, Eastern Europe and the European Bank for Reconstruction
and Development, 28 INT’L LAW. 433, 437 (1994); see infra notes 26–50 and accompanying text.

5 Easton & Rorer, supra note 3, at 527.
7 PAUL A. MENKVELD, ORIGIN AND ROLE OF THE EUROPEAN BANK FOR RECONSTRUCTION AND
8 See infra note 50 and accompanying text.
9 See infra note 50 and accompanying text.
10 See EUROPEAN BANK FOR RECONSTRUCTION AND DEVELOPMENT, Chairman’s Report on the
Agreement Establishing the European Bank for Reconstruction and Development, in BASIC DOCU­
MENTS OF THE EUROPEAN BANK FOR RECONSTRUCTION AND DEVELOPMENT 53, 55, art. 4 (1991)
[hereinafter Explanatory Notes]. “The essential European character of the Bank lent itself to
the denomination of its original authorized capital stock in the European Currency Unit, the
ECU.” Id.
12 The official name of the World Bank is the International Bank for Reconstruction and
Development. The World Bank has several affiliates, the International Development Associa-
of the Bank states that the purpose of the EBRD "shall be to foster the transition towards open market oriented economies and to promote private and entrepreneurial initiative in the Central and Eastern European countries committed to and applying the principles of multiparty democracy, pluralism and market economics." Moreover, the Preamble of the Agreement provides, in pertinent part, that the contracting parties are "[c]ommitted to the fundamental principles of multiparty democracy, the rule of law, respect for human rights and market economics" and welcome "the intent of the Central and Eastern European countries to further the practical implementation of multiparty democracy, strengthening democratic institutions, the rule of law and respect for human rights and their willingness to implement reforms in order to evolve towards market-oriented economies." The overt political nature of the EBRD's mandate is a radical departure, a never-before-used approach in multilateral development financing institutions.

The Bank's political mandate illustrates its post Cold War character. More fundamentally, the Bank can be viewed as a significant foreign policy tool of its powerful Western shareholders. An institution with such a political mandate, operating in critical and sensitive regions in Central and Eastern Europe, necessarily implicates foreign policy considerations. This is true for the EU and its Member States, which share geographical proximity to the countries of Central and Eastern Europe, as well as for the United States, the last remaining superpower.

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13 Agreement, supra note 1, art. 1.
14 Agreement, supra note 1, pmbl.
15 Dr. Edward A. Hewitt, of the Brookings Institution, has testified before the U.S. Congress that the EBRD "is a good investment in democracy and in our national security, probably a far better investment than yet another weapons system or more spending on existing weapons systems." European Bank for Reconstruction and Development; Hearings Before the Subcomm. on International Economic Policy, Trade, Oceans and Environment of the Senate Comm. on Foreign Relations, 101st Cong., 2d Sess. 26-27 (1990) (statement of Dr. Edward A. Hewett, Senior Fellow, Brookings Institution).
16 Professor Eric Stein explains the role of democracy in foreign relations as follows: United States Secretary of State George Marshall told the General Assembly of the United Nations in 1948 that "[g]overnments which systematically disregarded the rights of their own people were not likely to respect the rights of other nations and
From a financial or commercial perspective, the EBRD is necessary to deal with critical capital shortfalls that Central and Eastern European countries have experienced during their transition from socialism. Without capital, the embryonic private sectors of these countries would die an early death. Commercial banks, however, have been leery about investing substantial sums in Central and Eastern Europe because of their adverse experiences with sovereign risk in the Latin American debt crisis.\(^{17}\) Commercial bank lending will relate substantially to the activities of the significant corporate clients of such banks.\(^{18}\) Also, the confidence of commercial banks in the creditworthiness of the Central and Eastern European governments and their privatizing or newly privatized enterprises is a prerequisite to purely commercial lending by purely commercial banks.\(^{19}\) Such confidence depends heavily on legal and economic reform in the countries in question.\(^{20}\) The EBRD in part was created to alleviate these problems.

The Bank is an apparent product of current thinking in development economics, with its focus on small and medium enterprises, private enterprise development and the entrepreneur as the engine of development.\(^{21}\) Statist approaches to development do not accord with current dogma in development economics. These philosophies are by no means limited to the promotion of economic other people, and were likely to seek their objectives by coercion and force in the international field.

History confirms that it is the democratically governed states that by definition are likely to respect basic rights of their people—and there is impressive empirical evidence that, "[w]ith only the most marginal exceptions, democratic states have not fought each other in the modern era"; hence a democratic world would be "a more peaceful world."


\(^{19}\) Id.

\(^{20}\) Id.

wealth, as the entrepreneur can be viewed as the engine of democratic pluralism.\textsuperscript{22}

The Bank has been very busy in its few years of existence. Since its founding in April 1991, the Bank has created a portfolio of 159 projects as of its quarterly financial statements of September 30, 1994, with a total value of ECU 3.6 billion.\textsuperscript{23} The Bank is operating at a loss, but not at amounts that would be considered excessive or out of control for a development bank.\textsuperscript{24} The Bank’s projects include loans, project financing and increasing levels of equity investments in private enterprises.\textsuperscript{25}

This Article attempts a comprehensive analysis of the EBRD’s formation and activities. Section I examines the origins of the EBRD. Section II examines two significant policies which are collateral to the Bank’s financing activities: the requirement that the Bank consider environmental issues in its activities, and the political conditionality of the Bank. Section III provides a detailed analysis of the EBRD’s policies that directly relate to financing. Section IV examines the role of the Bank in the context of the EU and trade liberalization between members of the Union and the countries of Central and East Europe. Section V concludes the Article by explaining that the Bank may present a positive model for sustainable development.

I. THE ORIGINS OF THE EBRD

President Francois Mitterrand first declared the idea of the EBRD in a speech before the European Parliament on October 25, 1989.\textsuperscript{26} The general notion of a multilateral development institution for Central and Eastern Europe, however, was first conceived by Jacques

\begin{itemize}
    \item \textsuperscript{22} As stated by Professor Weber, “[s]mall businesses were important to EBRD not only because this sector promised to generate quick payoffs in economic activity but also because the attention to SMEs meshed comfortably with the new Bank’s special commitment to democracy.” Weber, \textit{supra} note 3, at 24. Professor Weber continues in the footnote: “That is, the development of new small businesses under the direction of private citizen entrepreneurs was thought to reinforce in Europe the political foundations of democracy, even as the economies of these countries as a whole suffered the aggregate traumas of transition.” \textit{Id.} at 24 n.70.
    \item \textsuperscript{23} \textit{European Bank for Reconstruction and Development, Quarterly Financial Report} 2 (Sept. 1994).
    \item \textsuperscript{24} See \textit{id}.
    \item \textsuperscript{25} \textit{Id}.
    \item \textsuperscript{26} Menkveld, \textit{supra} note 7, at 25. At the time, Mitterrand was President of the European Council of Heads of State and Government. \textit{Id}.
\end{itemize}
Attali in 1989, when he was a close advisor to President Mitterrand.27 Eventually, Attali became the first president of the EBRD. At the time of President Mitterrand's declaration, the concrete nature and characteristics of the EBRD had not yet been established. These characteristics subsequently had to be negotiated by the countries that later would found the Bank.

The details of what this new institution was to become can be viewed from polar extremes. The resulting structure and functions of the EBRD were a compromise of competing European, American and to some extent Japanese interests. Initially, the French touted a "maximalist conception" for the Bank.28 As explained by Professor Steven Weber, the French

... saw the Bank as absorbing all existing multilateral aid programs aimed at [Central and Eastern Europe], including the EC Poland/Hungary, Aid for Restructuring Economies (PHARE) program and the Polish Currency Stabilization Fund. In addition, it would supplant the emerging interests of the World Bank and the IMF. Thus its role would be far greater than the typical role of a regional development bank. Attali's proposal also envisioned a restricted membership or at least a severely restricted role for non-European states. "European," as defined by the French at this time, did not include the United States as a principal member.29

The opposite extreme to the French maximalist conception was the "no aid", free market conception, proffered by certain American nongovernmental institutions, notably scholars associated with the Cato Institute and the Heritage Foundation. Their arguments against any form of aid include, inter alia, that multilateral development

27 Attali's relationship with President Mitterrand has been described as follows:

"Attali is famous as an ideas man. 'Bubbling' is the word usually used to describe his production of ideas. . . . 'He is extraordinarily imaginative and creative' claims a colleague. . . . Francois Mitterrand has often testified that his intellectual fecundity is one of Attali's most valuable traits as an advisor, even if the ideas require considerable sifting. 'After all,' Mitterrand told one interviewer, 'it's enough if Attali gives me one good idea among the 10 he presents to me: that's already quite formidable.' . . . Attali says he first thought of the project in August 1989. He said 'it was an obvious idea, an obvious need.'"


29 Id.
institutions, such as the World Bank, the regional development banks, and the newest regional bank, the EBRD, cause aid dependency, contribute little to real reform, have been unsuccessful in alleviating poverty and promoting development, misallocate resources on the basis of bureaucratic planning rather than free market principles, and promote and maintain statist governments that fail to enhance the welfare of their citizens.30

Moreover, these scholars argue that the EBRD and other aid institutions distract attention from serious problems of lack of market access, in the EU and elsewhere, for the products of the Central and Eastern European economies.31 Dr. Edward Hudgins of the Heritage Foundation is of the view that the EBRD "could insure the Latin Americanization of Eastern Europe," and could cause a debt crisis in the region similar to the crisis that befell the Latin American countries.32 Melanie S. Tammen, a Cato Institute scholar, summarizes:

The World Bank's record throughout the developing world and in Eastern Europe overwhelmingly disqualifies it as a catalyst for radical change in the region. Similarly, the new EBRD is fundamentally a rearguard socialist undertaking. The last thing nations in transition need is multilateral development bank loans to politicize their economies.33

These scholars present an essentially American view of the world, based in classical economic theory and minimalist views of the role of government in society. One could contrast these views with a


31 Tammen, supra note 30, at 122-23; Hudgins, Ten Objections, supra note 30 ("[T]he Eastern Europeans themselves are not clamoring for such aid. Rather, they are asking for markets opened to their exports and direct foreign investment by Western businesses in their countries. These free market tendencies should be encouraged with open markets in the West, not with international welfare.").

32 Hudgins, Ten Objections, supra note 30.

33 Tammen, supra note 30, at 122.
traditionally continental European view, which some may argue relies on relatively statist conceptions of the role of government. As explained by one European official, in the deliberations concerning the EBRD's structure: "As Europeans, we view American attitudes towards the public sector as dogmatic. They perceive it as necessarily negative. We agree on promoting private enterprise, but we'd like less rigidity. Their attitudes show a lack of trust in the board of administration." The EBRD thus could be examined from the point of view of competing roles of government in the Western tradition.

The initial view of the Bank by the U.S. Government was to some degree in accordance with that of the above American scholars. As summarized by one scholar:

Top Treasury Department officials, wary of the poor track record other regional development banks have had in trying to support private-sector development, argued on technical grounds that EBRD was at best unnecessary, since left to its own devices the "market"—meaning private investors—would more efficiently allocate capital for the needs of [Central and Eastern Europe].

At the time, however, the United States decided to involve itself in such a large project so early in the post Cold War period because of pragmatic political considerations. The United States thus has not adopted a strict "no aid" approach. Nevertheless, the United States is skeptical of creating new institutions without at least considering the efficacy of existing ones, and considering whether the World Bank could perform the functions of a new bureaucracy.

The EU endorsed a "minimalist conception," somewhere between the free market approach of American libertarian scholars and the maximalist conception propounded by the French Government. This minimalist conception did not question the need or utility of a multilateral development institution. The approach of the EC was to have the EBRD "act in concert with, rather than try to subsume, other aid initiatives in [Central and Eastern Europe]." The EC wanted to preserve the "Europeanness" of the institution yet still

34 Pierre Townsend, Europeans Worry EBRD has been Co-opted by U.S., ANN. MEETINGS NEWS, Sept. 23, 1990, at 35, quoted in MENKVeld, supra note 7, at 62.
36 Id.
37 Id.
38 Id. at 15.
39 Id.
allow other countries, notably the United States and the Soviet Union, to become members of the Bank.40

The politics of the period were inextricably tied to competing views of the putative role of the EBRD. Political considerations outweighed any theoretical economic issues concerning the EBRD’s role. At the time, Germany had been able to provide significant bilateral aid and private investment to its neighboring states in Central and Eastern Europe.41 In contrast, France, lacking the resources of Germany, viewed the Bank as a way to leverage its power in regions to be served by the Bank.42

The United States had significant economic and political interests in these regions.43 In fact, successful reform would serve as a counterweight to the then Soviet Union.44 American involvement in the region was designed to push the EU to become less protective and insular and more of an international actor.45 Leadership of the EU in the EBRD could serve to facilitate a more broadly focused Union with less protected markets.46

Ultimately, the Bank emerged from a synthesis of philosophies and power bases. The main characteristics of the Bank, as negotiated by the initial members, are as follows:

1) Political conditionality. The Bank is the first multilateral development institution to have as its express purpose the fostering of multiparty democracy, pluralism, market-oriented economics, rule of law and human rights;47

2) Environmental protection. The Bank is required by its Articles of Agreement to promote and take into account environmental concerns and the concept of sustainable development in an environmental context;48

3) Emphasis on the private sector. After hard bargaining in the short period in which the Bank’s Articles of Agreement were prepared, the American view that the Bank should focus on private sector development prevailed. The Bank is required to invest at least sixty percent of its funds in the private sector and in privatization. The

40Weber, supra note 3, at 15.
41 Id. at 8.
42 Id. at 9.
43 Id. at 10.
44 Id.
45 Weber, supra note 3, at 10.
46 Id.
47 See infra notes 65–112 and accompanying text.
48 See infra notes 52–64 and accompanying text.
Bank combines the concept of a merchant or investment bank with that of a development bank;49 and

4) European majority. Although the United States is the single largest shareholder and exerted some influence in the creation of the Bank, the Bank is essentially a European institution. The majority of the Bank’s shares are held by the members of the EU. Its client states in Central and Eastern Europe also are members. The EU itself, and also the European Investment Bank, are shareholders.50

II. COLLATERAL POLICIES IN EBRD GOVERNANCE

The Articles of Agreement of the EBRD suggest a two-part framework for analysis of EBRD policies. First, there are collateral policies that the Bank must adhere to—policies that do not relate directly to the commercial or financial aspects of a Bank project. These collateral policies are the requirement of political conditionality in Bank operations and the environmental protection mandate of the Bank. Second, there are direct policies that the Bank applies in its day-to-day financing operations—policies that relate directly to the soundness of investments and loans. This section examines collateral policies.51

A. Environmental Protection—Sustainable Development

The EBRD’s Articles of Agreement expressly require the EBRD to take measures “to promote in the full range of its activities environmentally sound and sustainable development.”52 This is the first instance in which the charter of a development institution formally requires that the institution take environmental issues into account in its activities.53 One authoritative text describes this provision as containing “modern language,”54 which is interpreted to mean that

49 See infra notes 113–17 and accompanying text.
51 For a discussion on the dichotomy between direct and collateral policies, see John Cibinic, Jr. & Ralph C. Nash, Jr., Formation of Government Contracts 942 (1986).
52 Agreement, supra note 1, art. 2(1)(vii).
54 Shihata, A Comparative Analysis, supra note 50, at 48.
the provision reflects what now is considered good policy for multilateral development institutions. The Explanatory Notes to the Articles of Agreement provide, in pertinent part, the following environmental mandate:

Delegates recognized the serious environmental problems in Central and Eastern Europe, and emphasized that principles of environmentally sound development must be integrated into the full range of the Bank's operations. Thus, Delegates intended "in the full range of its activities" to include all of the Bank's activities, including technical assistance and all special operations, and not merely that the Bank should be able to provide support directly for specific environmental projects.55

Legal scholarship appears to have addressed the environmental issues relating to the Bank more than any other subject.56 The pertinent literature has either been critical or has recommended various methods of implementation of the Bank's environmental mandate. Recommendations center on the idea of creating bureaucratic review structures in or by the Bank.

The borrowing countries are struggling with establishing democracies; they are in transition.57 One sign or function of working democracy is participatory pluralism—the involvement of people and groups in political decisionmaking, and not merely at the voting polls.58 Therefore, institutions designed to involve public participa-
tion should primarily be at the country or community level, rather than at the Bank level.

Moreover, the proposals are not practical without the precondition of sufficient legal infrastructure in the countries in question. At this time, however, the necessary legal infrastructure is, in all probability, inadequate in many countries served by the Bank. In addition, one must be wary of any attempted transplantations of laws and bureaucratic structures from one country to another that do not account for country-specific idiosyncrasies. Approaches that too closely resemble the U.S. National Environmental Policy Act and other U.S. laws dealing with environmental assessment may not be readily transplantable to Central and Eastern Europe without adaptation. These types of laws are difficult to administer even in the West; the practicality of their proper administration in the East should be considered.

the radical Llewellyn of the 60’s, is well aware that “The first requirement of a sound body of law is that it should correspond with the actual feelings and demands of the community.”

Zaphiriou, supra at 93 (quoting Oliver Wendell Holmes, The Common Law 38 (M. Howe ed., 1963)).

See Present at the Creation, supra note 56, at 86 (arguing for development of market infrastructure as a priority).

See Honorable Roberto G. MacLean, Judicial Reasoning and Social Reality in Peru, 28 Am. J. Comp. L. 489, 490 (1980). Central and Eastern Europe should avoid what has happened in Latin America. As described in the context of Peru:

In Peru, legislation often is drafted without the necessary studies and information. The national reality has just begun to be explored and, faced with a lack of facts and figures and ignorant of precise situations to be regulated in many cases, legislation is done “by ear,” frequently working from the legislative models available from other countries. Recourse to comparative law as an aid to the legislator, if made injudiciously, carries with it the danger of causing a serious distortion of the juridical function. Laws are a reflection of the conflicting interests existing in a society and its duty is to neutralize them and put them in equilibrium. For this reason, when a law is transplanted from one country to another, it may be that in the new country the law does not satisfactorily resolve the conflicts between interests, simply because the conflicts are distinct. In such cases they remain at least partially up in the air and without resolution. It then falls to the judge, if he is not content with formal solutions, to face the contradiction between law and reality; between a foregone conclusion contained in the model and the real conduct of people.

Id. at 490.


This is not to say that substantive environmental standards should not be harmonized. It is axiomatic that nature and its degradation by man know no political boundaries. Rather, the procedures by which substantive environmental standards are enforced may vary in countries,
The EBRD’s borrowing countries should be concerned with any undue allocation of responsibilities to them to pay for the massive investments needed for environmental remediation and protection. Admittedly, the State, in these countries, caused significant environmental damage. Nevertheless, any aid programs should approach this problem as a European problem and not merely as national problems of single countries. The problem involves externalities; the Western Europeans will benefit greatly from cleanup in Central and Eastern Europe. Moreover, this would seem to be an area in which commercial loans, in accordance with sound banking principles, may not always be the best financing approach. However, maximizing ways to employ this approach would be beneficial nonetheless.

B. Post Cold War Orthodoxy in the EBRD’s Articles of Agreement

The EBRD’s Articles of Agreement set forth a strong set of provisions that condition the Bank’s operations on political considerations. The Preamble to the Articles presents important underpinning particularly as between the United States and the countries of Central and Eastern Europe. In public law, one finds great variations among national legal systems.

As explained by the economist Jan Vanous:

I am particularly disturbed by the suggestion that the Bank should go into environmental lending. This is a cop-out. Any economist will tell you that if you want to invest in the environment there are lots of externalities. If I was an East European I would say fine, lend me money, and I will clean up the environment, but the benefit is not only for me but also for the neighbors. To demonstrate the illogic of the situation, why would West Germany spend extra deutsche marks on something that cleans up the West German environment that is costly on a marginal basis, while if it only spent the same money fifty kilometers eastward across the border the benefit would be five-fold, and most of it would be felt in West Germany as well? There is a very strong argument for subsidization of the process. I think if the West wants the environment to be cleaned up because it would significantly benefit from it, it ought to subsidize it. The Germans understood this a long time ago and particularly when it came to dealing with the GDR. They figured out that if you want a clean Elbe River, you should pay the East Germans and help them to build cleanup facilities, so that downstream we do not end up with dirty water. Environmental cleanup and things like that are very costly and, in my opinion, ought to be subsidized.

It is really the responsibility of the Europeans to get their act together and start thinking like Europeans. If you want to clean up Europe you have got to think globally now. You have got to be allocating the resources rationally because the air moves all around, you cannot contain it. If you clean up in your own country it is not going to help if your neighbor is still polluting. Your neighbor may not be able to afford the expensive pollution equipment. Even if you give them loans they will not be able to do it.

Present at the Creation, supra note 56, at 87.

See infra notes 113–67 and accompanying text on the Bank’s lending policies.
nings for the Bank’s existence, including a commitment of the contracting parties “to the fundamental principles of multiparty democracy, the rule of law, respect for human rights and market economies.” The Preamble refers to the Final Act of the Helsinki Conference on Security and Cooperation in Europe, and its Declaration of Principles, which has set forth significant principles in providing for an emerging right of democratic self governance. Finally, the Preamble welcomes “the intent of Central and Eastern European countries to further the practical implementation of multiparty democracy, strengthening democratic institutions, the rule of law and respect for human rights and their willingness to implement reforms in order to evolve towards market-oriented economies.”

Article 1 of the Bank’s Article’s of Agreement presents the Bank’s purpose as follows:

In contributing to economic progress and reconstruction, the purpose of the Bank shall be to foster the transition towards open market oriented economies and to promote private and entrepreneurial initiative in the Central and Eastern European countries committed to and applying the principles of multiparty democracy, pluralism and market economics.

Paragraph 1 of Article 8 of the Bank’s Articles of Agreement provides that “[t]he resources and facilities of the Bank shall be used exclusively to implement the purpose and carry out the functions set forth, respectively, in Articles 1 and 2 of this Agreement.” Paragraph 2 of Article 8 provides that “[t]he Bank may conduct its operations in countries from Central and Eastern Europe which are proceeding steadily in the transition towards market-oriented economies and the promotion of private and entrepreneurial initiative, and which apply, by concrete steps and otherwise, the principles as set forth in Article 1 of this Agreement.”

65 Agreement, supra note 1, pmbl.
67 Franck, supra note 58, at 66–68.
68 Agreement, supra note 1, pmbl.
69 Id. art. 1.
70 Id. art. 8(1).
71 Id. art. 8(2).
of the Bank is to review, at least annually, the Bank’s operations “to ensure that the purpose of Bank, including by implication the political aspects of its mandate, is fully served.”

The Bank’s political mandate is the result of United States and Japanese insistence during the negotiations of the Articles of Agreement. There was no consensus among EC states on this issue. France and several other states were opposed to political conditionality. The European divisiveness is puzzling, given the sweeping pronouncements of the Conference on Security and Cooperation in Europe on entitlements to democratic governance in Europe.

The U.S. position could be viewed, at first blush, as ideological or idealistic. It does, however, have a pragmatic base in ensuring that the Bank does not promote the continued existence of statist regimes and command economies, or reverse the gains made in Central and Eastern Europe towards democracy. The American view is that if the Bank is to play a role, it must play a positive role in

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72 EUROPEAN BANK FOR RECONSTRUCTION AND DEVELOPMENT, POLITICAL ASPECTS OF THE MANDATE OF THE EUROPEAN BANK FOR RECONSTRUCTION AND DEVELOPMENT 2 [hereinafter POLITICAL ASPECTS]. The relevant provision in the Articles of Agreement is Article 11(2)(i).

73 MENKVELD, supra note 7, at 53.

74 Id.

75 Id.

76 See Franck, supra note 58, at 66–69.

77 Present at the Creation, supra note 56, at 79 (“The most significant problem is the rigidity, reflecting ideological positions, proposed to be written into the charter, which presents serious dangers for a new institution. In my view this problem . . . has been needlessly created by the United States.”).

78 Id. at 82–83. Howard Hills, former Vice President and General Counsel for the Overseas Private Investment Corporation, has explained as follows:

I do not think it is ideological . . . for the United States to take the position that this bank should function in a way that does not reinforce the parastatal regime in these command economies. It is not ideological for the United States to insist that privatization be a priority for the EBRD. The United States wants to ensure that the Bank functions in a way that actually promotes the development of market economies. The reason I reject labeling the U.S. position as ideological is that I believe the U.S. Government’s policy is consistent with the democratic aspirations of the peoples concerned. The Bank should respond to grass-roots movements of the people in those countries, and unless I am reading the situation wrong, I think what they are asking for is democratic government and a market economy not dominated by the economic elite that became entrenched in the Communist era . . . .

Lech Walesa and the Solidarity union did not put themselves at risk and did not bring about one of the most radical political and social transformations of this century in order to have a multilateral development bank or any other investment promotion program come in and reinforce the command economy and parastatal regime that existed under the Communist government.

Id.
progressing the borrowing countries toward some form of coherent, market oriented democratic framework. Of course, this is the preferred American approach to development aid. Presumably, underlying all of this is the principle that democracies tend not to go to war with one another.

Reversal of the gains made in recent years could lead to an even more unstable world in which authoritarian governments, with no incentives to adhere to liberal democratic principles, vie for power. Ideology and pragmatism are not easily segregable concepts in the post Cold War world, at least in the American view of that world. From a European point of view, the convergence of economics and politics cannot be avoided, and indeed is the basis of the EU.

The differing views between the Americans and the Europeans on such policies have an arguable basis in historical views of the proper roles of foreign policy. Although the Western countries may differ in foreign policy approaches, the EBRD appears to be a significant foreign policy tool, particularly when its political conditionality is considered. The American view of the Bank is that it is a “foreign policy-oriented European initiative that would ‘demonstrate the political commitment of Western Europe to and solidarity with the [Central and Eastern European] countries and at the same time include the United States in a key supportive role.’” Since trade agreements often have their roots in foreign policy, there is no reason why a multilateral development institution would not have similar roots. The EBRD allows the United States and other countries to leverage principles as well as aid funds.

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79 See Weber, supra note 3, at 21.
80 Stein, supra note 16, at 427.
81 See Weber, supra note 3, at 23.
85 Rep. James A. Leach, A Republican Looks at Foreign Policy, 71 FOREIGN AFF. 22 (Summer 1992) (“[I]n addition to leveraging dollars, these institutions allow the West to leverage principles. Few governments are prone to bow to pressure for market-oriented reform coming from a single country. Many, however, will institute politically difficult reforms as prerequisites for IMF and World Bank support.”).
The Bank has published criteria on its political mandate. These criteria make it evident that, as to political conditionality, although the Europeans lost the war, they won the peace. European standards and norms are applied by the Bank in its political assessments and activities.

The founding countries of the Bank provided no meaningful details on how the Bank is supposed to apply the political criteria set forth in its charter. "While the details were not filled in," however, "it was clear that consensus about EBRD's political mandate went beyond the World Bank's notion of 'good governance' toward a more elaborate set of political attributes related closely to the EC's standards." The Bank looks to such European institutions and documents as the Council of Europe, the European Convention on Human Rights, the Declaration on Principles of the Final Act of the Helsinki Agreement, the Document of the Copenhagen Meeting on the Conference on the Human Dimension of the CSCE, the CSCE Charter of Paris for a New Europe and the European Commission on Human Rights.

Commentators have expressed concern that "strong socialist traditions" in Western Europe could make the operation of the political mandate of the Bank suspect. These criticisms, however, do not focus on the larger issues. The need is for the countries of Central and Eastern Europe to formulate and apply their own version of multiparty democracy and market economics, without too much

86 See generally Political Aspects, supra note 72; European Bank for Reconstruction and Development, Political Aspects of the Mandate of the European Bank in Relation to Ethnic Minorities (1993) [hereinafter Ethnic Minorities].
88 See Weber, supra note 3, at 17.
89 Id. at 19; see also Easton & Rorer, supra note 3, at 528. For a critical review of World Bank policies, see Cahn, supra note 12.
91 Final Act, supra note 66.
94 Political Aspects, supra note 72, at 3; Ethnic Minorities, supra note 86, at 3, 6-11.
95 Hearing Before the Subcomm. on International Development, supra note 18 (statement of Dr. Hudgins); see Present at the Creation, supra note 56, at 94 ("Strong socialist traditions" such as that of Austria "is not a model we want to see.").
emphasis on the pedigree of the institutions, so long as what they create can honestly be said to fall within established paradigms. To some, there is no such thing as a completely free market or a wholly privatized state, nor do markets somehow inexorably arise from nature.96 The countries in question will probably never resemble the United States in their approach to the issues; they have different legal and national cultures. These countries should emulate the standards of the EU, since it is in their national interests to someday join the Union. Of course, one would hope that these countries, and the Bank, will learn from the mistakes of past statist approaches of the nations of Western Europe and of other regions.

Commentators have suggested that potential unfavorable decisions by the EBRD based on political criteria could expose the EBRD to charges of interference in domestic affairs or infringement of sovereignty.97 For example, what if the government of a borrowing country undertakes an approach based on the Chinese model of economic development, in which economic reform and political repression are combined?98 An even more difficult question is how the Bank would deal with some of the more subtle forms of authoritarianism that seem to be on the rise in the world.99 In addition, how should the Bank deal with the issue where there is no loan default from a commercial point of view, and declaration of default would not be sound banking practice? These are sovereign risks that the Bank inevitably will have to address because of its political mandate.

In this author’s view, the Bank has sufficient discretion to take appropriate action, and arguments of interference or intervention fail to withstand serious scrutiny. As a threshold matter, the borrowing countries are shareholders in the Bank. The Bank lends to

97 Easton & Rorer, supra note 3, at 535.
98 As explained in Weaver & O’Keefe, supra note 21, at 126:

Efforts to reform Soviet-style economies have been particularly difficult. If the Soviet Union represents one extreme—political reform first, followed by failed economic reform—China represents the other extreme—economic reform without subsequent political reform. As of 1991, it seems that the Chinese have been more successful: Their economic reform is proceeding, without interruption, in spite of the government’s having destroyed the country’s democratic forces.

Id.

members. These members fully and freely consent to the Bank's Articles of Agreement. They have given up part of their sovereignty in the execution of the Articles of Agreement, which is a treaty.\textsuperscript{100}

The Bank, in essence, is a credit cooperative, providing valuable leverage of the capital of its members. Article 13 of the Bank's Articles of Agreement provides that "the Bank shall not finance any undertaking in the territory of a member if that member objects to such financing."\textsuperscript{101} The borrowing countries accept assistance from the Bank, and allow their private enterprises to accept such assistance, despite the political conditionality of the Bank's activities, and with full awareness of this conditionality. Indeed, an arguable conflict of interest would seem to exist in making any sort of intervention argument in this context.

Article 8 of the Bank's Articles of Agreement provides, in pertinent part, as follows:

In cases where a member might be implementing policies which are inconsistent with Article 1 of this Agreement, or in exceptional circumstances, the Board of Directors shall consider whether access by a member to Bank resources should be suspended or otherwise modified and may make recommendations accordingly to the Board of Governors. Any decision on these matters shall be taken by the Board of Governors by a majority of not less than two-thirds of the Governors, representing not less than three-fourths of the total voting power of the members.\textsuperscript{102}

The measures that the Bank may take include postponement of proposed operations, restrictions on operations, and suspension of operations.\textsuperscript{103} The Bank, however, is wary of unduly restricting private sector or community incentives when faced with an oppressive national government. Thus, the Bank's guidelines include "curtailing planned public sector projects before taking action on private operations. Within the public sector it might curtail state infrastructure projects before local ones and endeavor to continue with its technical cooperation activities as long as possible."\textsuperscript{104}

\textsuperscript{101} Agreement, supra note 1, art. 13(iii).
\textsuperscript{102} Id. art. 8(3).
\textsuperscript{103} See \textit{Political Aspects}, supra note 72, at 5.
\textsuperscript{104} Id.
Concerning decisions based on political criteria that would be inconsistent with sound banking practice, the Bank, as a matter of prudence, “will need to consider its own financial position as well as the legitimate financial interests of relevant third parties” in any analysis of the issues. The Bank must be careful not to place itself in vulnerable positions that could be exploited by the unscrupulous in countries with fledgling democracies.

Although there was some disagreement in Paris in the negotiations over the EBRD, those negotiations occurred very quickly and the result included overt political conditionality for the EBRD. Indeed, the Bank’s Articles of Agreement and its operations lend support for the notion of an emerging human right of democratic governance. Professor Thomas Franck argues that the right of peoples to democratic governance is becoming a norm in public international law. This emerging norm has a strong basis in European foreign policy and in the formation and extension of the EU. In fact, in documents relating to the Conference on Security and Cooperation in Europe, the European States, including those of Central and Eastern Europe, and also the United States and Canada, spell out their collective beliefs in the right of democratic entitlement, including free elections, representative government and validation of the right to govern based on democratic succession to power. The emerging norm, if it ever becomes universally recognized, could significantly change traditional principles on nonintervention. This putative norm may, in the future, delimit arguments based on sovereignty and interference.

This evolving norm may be even more developed in a regional sense in Europe. The signatories to the CSCE documents have pledged the following:

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105 Id.
106 See supra notes 3, 47 and accompanying text.
107 Franck, supra note 58, at 46.
108 Professor Weber explains:

Creating EBRD depended on an emerging partial consensus about the relationship between the state, democracy, and market economies, part of a historically and geographically specific stream of ideas about the shape and character of a future Europe and its relations with the rest of the world.

109 Hereinafter referred to as “CSCE.”
110 Franck, supra note 58, at 64-67.
[We] will support vigorously, in accordance with the Charter of the United Nations, in case of overthrow or attempted overthrow of a legitimately elected government of a participating State by undemocratic means, legitimate organs of that State upholding human rights, democracy and the rule of law, recognizing their common commitment to countering any attempt to curb these basic values.\textsuperscript{111}

One public international law scholar, Judge Thomas Buergenthal, explained the shrinking \textit{domaine reserve} in Europe as follows:

\[
\text{[N]o domestic jurisdiction or norm, in theory, is beyond the jurisdictional reach of the CSCE. Here the traditional domestic jurisdiction doctrine, which has tended to shield the oppressive state practices and institutions from international scrutiny, has for all practical purposes lost its meaning. And this notwithstanding the fact that non-intervention in the domestic affairs of a state is a basic CSCE principle. Once the rule of law, human rights and democratic pluralism are made the subject of international commitments, there is little left in terms of governmental institutions that is domestic.} \textsuperscript{112}
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There are thus convincing arguments against any strong nonintervention principle in Europe, in connection with Bank activities which are the subject of the CSCE documents.

\textbf{III. EBRD Policies Directly Relating to Lending}

Pursuant to its charter, the Bank has a private sector emphasis; it may commit no more than forty percent of its funds to the state sector.\textsuperscript{113} Given this focus, the Bank combines the functions of an investment bank with a development bank.\textsuperscript{114} It is critical that the Bank provide financing to the private sector in order to avoid maintenance of undesirable state enterprises in the countries in ques-


\textsuperscript{112} Franck, supra note 58, at 68 (quoting Thomas Buergenthal, \textit{CSCE Human Dimension: The Birth of a System}, in \textit{1 Collected Courses of the Academy of European Law}, No. 2, at 3, 42–45).

\textsuperscript{113} Agreement, supra note 1, art. 11(3)(i).

\textsuperscript{114} Newburg, supra note 4, at 454.
tion. This focus directly relates to the economic reform in Central and Eastern Europe. It also safeguards against the potential for ineffectiveness in public sector financing, a type of financing that some view as a primary cause of the Latin American debt crisis and of the severe economic problems that the Latin American countries faced in the 1970s and 1980s. It is truly a difficult task for a multilateral financial institution, however, to unleash entrepreneurial spirit in developing countries.

In its recent reorganization and under its new President, Mr. Jacques de Larosiere, the Bank appears to have leaned toward a more traditional development banking model, de-emphasizing an initial aggressive investment banking image. The Bank’s organization now more closely resembles that of the World Bank. The EBRD should be wary of emulating too closely the World Bank. The EBRD’s charter is quite different than that of the World Bank, and, in addition, the World Bank has been subject to criticism for its lack of effectiveness in its role in the public sector.

The following sections discuss the following types of financing that the Bank is equipped to provide: loans to private enterprises, loans to the public sector, and the making of equity investments. Moreover, these sections examine the prohibition in the Bank’s Articles of Agreement of policy-based loans.

A. Private Sector Development

Article 11 of the Bank’s Articles of Agreement provides for the following types of loans: (1) loans to private enterprises “without

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115 See Hearings Before the Subcomm. on International Development, supra note 18, at 14 (statement of David C. Mulford); see also Present at the Creation, supra note 56, at 82–83.
116 See, e.g., Hearings Before the Subcomm. on International Development, supra note 18, at 28, 49, 58 (statements of Dr. Edward Hudgins and Horst Schulman).
118 See Weber, supra note 3, at 24.
120 Agreement, supra note 1, art. 11(1)(i). Article 11 states:

[M]aking, or cofinancing together with multilateral institutions, commercial banks or other interested sources, loans to private sector enterprises, loans to any state-owned enterprises operating competitively and moving to participation in the market-oriented economy, and loans to any state-owned enterprise to facilitate its transition to private ownership and control; in particular to facilitate or enhance the participation of private and/or foreign capital in such enterprises.

Id.
restriction"; and (2) loans to state enterprises “operating competitively and moving to participation in the market-oriented economy”, and (3) loans to state enterprises “requiring funds to facilitate their transition to private ownership and control.” This article explicitly provides that a state enterprise is not operating competitively unless it is both operating autonomously in a competitive market environment and is subject to bankruptcy laws.

The Bank applies the following policies in its financing activities:

1) The Bank’s general minimum lending requirement is 5 million European Currency Units (ECUs).

2) The Bank provides project-based lending, often to joint ventures. Credit risk may be on the Bank’s balance sheet or the Bank may do a partial syndication.

3) A loan typically is secured by a borrower’s assets. The Bank also may secure a loan on assignment of the hard and local currency earnings of an enterprise, on a pledge of shares, on the assignment of insurance proceeds, and on other contract proceeds.

4) The Bank lends in hard currencies, usually the Deutschmark, the U.S. dollar or the ECU, and requires that the borrower repay the loans in the currency in which the funds were originally provided. This is a standard commercial bank approach, although it is on the conservative side—the Bank could allow the borrower to repay in any hard currency.

5) The Bank does not have the ability to make “soft” loans at concessionary or subsidized rates. Accordingly, it typically sets its interest rates at a margin over a market benchmark rate, normally the Libor rate. Rates will depend on commercial risks and country risks, although the latter type of risk “is mitigated by the EBRD’s status as a preferred creditor.”

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121 Dunnett, supra note 117, at 582.
122 Agreement, supra note 1, art. 11(1)(i).
123 Id. art. 11(1)(iii).
124 Id. at 11(1)(i).
125 FINANCING WITH THE EBRD, supra note 2, at 4.
126 Id. at 6.
127 Id. at 4-5.
128 See infra notes 160-61 and accompanying text.
129 Id. at 6.
130 Id. at 4-5.
131 EUROPEAN BANK FOR RECONSTRUCTION AND DEVELOPMENT, EXTERNAL FINANCING 2 (1994) [hereinafter EXTERNAL FINANCING].
6) Loan maturities generally range from between five and ten years, and repayment of principal normally will be in equal, semi­annual installments.\textsuperscript{132}

7) The Bank charges the borrower various fees and expenses, for such services as administration of the loan, technical consultants and outside counsel.\textsuperscript{133} This procedure is in accordance with commercial practice.

8) The Bank may engage in limited recourse financing. It generally does not seek guarantees from governments for private sector loans or from foreign parties involved in the project once a project is operational because cash flow from the project will provide a form of security. The Bank may seek performance and completion guarantees from project sponsors.\textsuperscript{134}

9) When appropriate, the Bank will encourage co-financing. The Bank will employ four types of co-financing: a) joint financing, where loans from the EBRD and the co-financiers are used to finance the same set of goods or services for a project; b) parallel financing, where the loans finance different sets of goods and services for the same project; c) syndication, in which other financial institutions “commit to lend under the Bank's documentation on terms reasonably similar to those under which the Bank is prepared to lend”; and d) syndicated participation, where the Bank funds an entire loan and after closing sells a participation to another financial institution or institutions.\textsuperscript{135} The last method is a funding mechanism in which the Bank remains committed to disburse the entire amount of the loan but seeks financing from other institutions.\textsuperscript{136} The Bank is interested in providing incentives for commercial banks and private investors to provide financing. The principal means by which the Bank currently involves commercial banks is through syndicated participations.\textsuperscript{137} Commercial banks in many countries recognize, either formally or informally, that participations should be given

\textsuperscript{132}\textit{FINANCING WITH THE EBRD, supra} note 2, at 5.
\textsuperscript{133}\textit{Id.} at 6.
\textsuperscript{134}\textit{Id.}

\textsuperscript{135}For discussions of co-financing by multilateral development institutions, see generally James R. Silkenat, \textit{The Role of International Development Institutions in International Project Financing: IBRD, IFC and Co-Financing Techniques}, 17 Int'l Law 515 (1983); Brenda S. Bishop, Note, \textit{The World Bank's New Co-financing Initiatives: Legal Mechanisms for Promoting Commercial Lending to Developing Countries}, 15 Law & Pol'y Int'l Bus. 911 (1983).
\textsuperscript{136}\textit{FINANCING WITH THE EBRD, supra} note 2, at 7.
\textsuperscript{137}\textit{Id.}

\textsuperscript{138}See \textit{EXTERNAL FINANCING, supra} note 131, at 3.
preferential treatment, and that participations are exempt from country risk provisioning requirements.\footnote{139}

10) The Bank, like other multilateral financial institutions, has a “preferred creditor status.”\footnote{140} The Bank attempts to mobilize private sector funds by avoiding involvement in debt reschedulings for loans to, and guarantees by, member countries.\footnote{141} In addition, the Bank will not reschedule loans to private enterprises where the inability of the enterprise to pay the debt is based on a general foreign exchange shortage in the country in which the enterprise operates.\footnote{142}

11) The Bank will finance up to thirty-five percent of project cost for a “greenfield investment” or for long term capitalization of an established concern.\footnote{143} A greenfield investment is one in which the project is entirely new, and not an improvement upon existing capital.\footnote{144}

12) The Bank encourages mixed equity and debt financing.\footnote{145} This type of financing is often accomplished through the institution of the joint venture, in which the Bank requires a substantial equity contribution from investors.\footnote{146} Typical Bank private sector projects are based on no more than two-thirds debt financing and at least one-third equity financing.\footnote{147} The Bank and other financial institutions will provide the debt financing and the project sponsors will provide the equity financing.\footnote{148}

13) The Bank has expressed a preference for working through joint ventures. The “primary targets” of EBRD financing are “private companies or state-owned enterprises undergoing privatization and the creation of new companies, including joint ventures with international strategic investors.”\footnote{149}

14) The Bank has been developing nonrecourse project financing methods in order to minimize sovereign debt.\footnote{150} Such debt may be
in the form of loans or guarantees to the private sector.\textsuperscript{151} One example is the Bank’s use of build-operate-transfer methods of project financing.\textsuperscript{152}

15) The Bank has focused a great deal on how to assist small and medium sized enterprises.\textsuperscript{153} Loans to these type of enterprises, although small, could in many cases be fast-disbursing. The Bank has attempted to finance such enterprises through financial intermediaries and the G-7 countries.\textsuperscript{154}

Loans, and all other types of financing provided by the Bank, are governed by thirteen operating principles set forth in Article 13 of the Bank’s Articles of Agreement. The most notable of these guidelines requires the Bank to apply “sound banking principles” to operations\textsuperscript{155} and invest on financial terms and conditions taking account, \textit{inter alia}, of terms and conditions normally obtained by private investors for similar investments.\textsuperscript{156} The International Finance Corporation, which the EBRD more closely resembles than the World Bank, is not required to adhere to such requirements.\textsuperscript{157} These principles, moreover, do not seem to reconcile with the principle of subsidiarity set forth in the same article. The Bank may not undertake any financing when the applicant is able to obtain sufficient financing from other sources on terms and conditions that the Bank considers reasonable.\textsuperscript{158}

These principles present the Bank with a puzzling problem. If a commercial bank cannot make an investment because it would violate sound banking principles, how is the EBRD to make the investment? As Steven Weber explains, “why would a borrower accept the added burdens of political conditions if capital could be had from private lenders at the same market rates?”\textsuperscript{159} Mainly due to U.S. insistence, the EBRD has been denied the ability to make “soft” or concessionary loans.\textsuperscript{160} Loans are made on a market basis rather than on a subsidized or concessionary basis, although the Bank’s

\begin{footnotesize}
\begin{itemize}
\item[151] See id.
\item[152] Id.
\item[153] Id.
\item[154] Id. at 437.
\item[155] Id. at 437.
\item[156] Agreement, supra note 1, art. 13(i).
\item[157] Id. art. 13(xi).
\item[158] Agreement, supra note 1, art. 13(vii).
\item[159] See Dunnett, supra note 117, at 589 n.35.
\item[160] Agreement, supra note 1, art. 13(vii).
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\end{footnotesize}
credit rating may permit it to borrow at lower interest rates and charge lower interest rates.\textsuperscript{161}

The economic situation in Central and Eastern Europe exacerbates the problems associated with the inconsistency in the language in the Articles of Agreement. In these areas, there has been a serious shortage of private sector capital and an inadequate banking and financial infrastructure.\textsuperscript{162} The Bank’s continuation will depend on its prosperity and on the success of reforms and other reforming institutions. As the economies of Central and Eastern Europe continue their transition, the Bank will more easily meet its private sector financing commitments.

The Bank has provided the following explanation which appears, at least in part, designed to assuage concerns as to the inconsistencies in its Articles of Agreement:

The strongest comparative advantage of the Bank relative to other international financial institutions, aside from its regional focus, lies in its ability to operate both in the public and private sectors and to have at its disposal the broadest range and flexibility of financing instruments.\ldots In relation to private commercial banks, the EBRD’s main advantages lie, as a result of its shareholder base, in its willingness and ability to bear risk. This allows the Bank to act at the frontier of commercial possibilities and to be an effective “demonstrator.” It also shares the project risk by acting with other private sector entities, such as commercial banks and investment funds, as well as multilateral lenders and national export credit agencies. The EBRD assists companies that have difficulty in securing financing: as such, it complements the efforts of other lenders.\textsuperscript{163}

This complimentary relationship may explain how the Bank will work within the framework of commerciality and sound banking principles. It presents, however, undesirable competition between

\textsuperscript{161}\textit{Id.}


\textsuperscript{163}FINANCING WITH THE EBRD, supra note 2, at 3.
the Bank and private sector financing mechanisms. The question then is whether it is economically efficient for an institution, funded by member governments, to compete with the private sector. The Bank's efforts could result in a misallocation of resources. The Bank is an international organization established by treaty. It enjoys privileges and immunities that no commercial bank could ever enjoy.164

The ultimate issue in any of these arguments is whether private capital markets are adequate in the countries in question. Any economic analysis depends on an affirmative answer to this question. The "natural" markets theories of, among others, the Cato Institute scholars seem to be misguided.165 One must be careful not to beg the question in an analysis of capital markets in the countries in transition. It may be the practical and desirable end of the analysis that the Bank provides needed scarce capital in these countries.

Commercial type lending to private enterprises could minimize the opportunities for default to be considered as a political weapon against a country. Such use of default, however, is suspect and of questionable effectiveness.166 This minimization of politics is in conflict with the Bank's political mandate. How can the Bank apply political conditionality when its loans are required to be primarily commercial in nature? The Bank's Articles of Agreement effectively limit the Bank to applying political criteria on a program or country-wide scale, rather than during the negotiation and performance of loan obligations. Indeed, the Bank's reorganization has led to a de-emphasis of political issues.167

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164 See European Bank for Reconstruction and Development, Report to the U.S. SEC in Respect of the Issue of the Banks A$ 50,000,000 9% Bonds Due 2002 (Dec. 8, 1992) [hereinafter SEC Report] (containing standard language accompanying the EBRD's filings made with the U.S. Securities and Exchange Commission concerning the EBRD's privileges and immunities). The significance of this point has been expressed by Peter Fox, Adjunct Professor at the Georgetown University Law Center and Partner in the law firm of Mallesons Stephen Jaques.

165 See supra notes 95-96 and accompanying text.

166 See Kathleen M. H. Wallman, The Politics of Default: Politically Motivated Sovereign Debt Default and Repudiation, 20 Tex. Int'l L.J. 475, 477 (1985) (concluding that "when default is used as a foreign policy tool, the remedies it affords may be empty ones," and that "exercising default as a political weapon, when possible, is ill-advised: it is not in the interest of the lenders, the lenders' depositors and investors, the borrower, or the international financial system.").

B. Public Sector Lending

1. Infrastructure Development

The compromise struck in the negotiation of the Bank’s Articles of Agreement is that the Bank may commit no more than forty percent of its financing to the public sectors of the borrowing countries, and that this financing is limited to the purpose of developing infrastructure needed for market-oriented economies. Article 11(1)(v) provides that the Bank shall carry out its functions, inter alia, “by making or participating in loans . . . for the reconstruction or development of infrastructure, including environmental programmes, necessary for private sector development and the transition to a market oriented economy.” The Articles of Agreement, however, allow the Bank to count financing provided to state enterprises in transition to privatization as financing to the private sector. The EBRD combines the functions of the World Bank and the International Finance Corporation into one institution.

Ibrahim Shihata, the General Counsel of the World Bank, explains the EBRD’s focus as follows:

Direct loans to member countries for investment projects, which has been the main business of other [multilateral development banks], are less emphasized in the EBRD Agreement, and are listed as the last method of operation, confined to infrastructure, including environment programs, lumped together with technical assistance and conditional on being necessary for private sector development and the transition to a market-oriented economy.

Infrastructure development, however, is of vital importance to the countries of Central and Eastern Europe. The Bank’s development banking functions may be more important than initially thought by

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168 See Easton & Rorer, supra note 3, at 534–35.
169 Agreement, supra note 1, art. 11(1)(v).
170 Id. art. 11(3)(iii)(b).
172 SHIHATA, A COMPARATIVE ANALYSIS, supra note 50, at 61–62 (emphasis in original).
173 The term “infrastructure” refers to those functions and activities needed for a market-oriented economy, such as adequate legal and financial systems, macroeconomic policies and efficient government bureaucracy.
the Bank's founders. As explained in the context of World Bank priorities:

A recent review of World Bank group activities in support of the private sector has led to a focus on three priority areas: first, improving the business environment for the private sector through proper macroeconomic management, efficient resource allocation and the creation of supportive legal and regulatory framework; second, restructuring or privatizing public enterprises to ensure the efficient provision of infrastructure and services; and third, developing financial systems which provide the incentives and institutions required to mobilize and allocate financial resources efficiently.174

At first, the Bank viewed the problems in Central and Eastern Europe as “market failure” problems.175 Eventually, the Bank concluded that the lack of capital and foreign investment in the region was due in significant part to the lack of the infrastructure typical of market economies.176 The economic problems in these countries, particularly in the former republics of the Soviet Union, stem in part from “almost no economic infrastructure or preexisting practices from which development can proceed.”177 The building of market

176 See id.

Now let us focus on the discussion of whether this bank should lend to the public or the private sector. I think that the whole discussion is very confused. You cannot be lending anything to private entities in the foreseeable future. There won’t be any entities that are worth lending to—it will take quite awhile before these are created. Moreover, what is the point of lending to private entities? For that we have commercial banks. What this institution ought to do is one thing—lend to create market infrastructure. But you cannot find a private partner for it—you need a committed government—and if you trust a government that is turning something into a market economy you will have to lend to the government. I would like to see them, for example, lending to create a stock market. Now, who am I going to lend to, a bunch of guys who say, “We are creating a stock market”? [sic] I would probably have to have the Ministry of Finance and the National Bank in it—in other words, the state agencies. So it is the purpose of the project that is critical, not to whom you lend; because if you then see that they are misusing the money or not doing what they are supposed to be doing, you pull the money out. I do not see what the problem is. Formulas on this are ridiculous.

Present at the Creation, supra note 56, at 86.
infrastructure should help to resolve the previously discussed problem for the Bank, caused by the lack of sound commercial projects, by helping to create a firm footing for application of sound banking principles by the Bank.

The Bank's recent focus on development of market infrastructure has a European character. The EBRD can focus on linkage of its infrastructure projects on both economic integration in Europe and on the purely domestic needs of its borrowing countries.178 The EBRD has an important role in post Cold War Europe, based in part on its assistance in the integration process and ultimately in fostering long term stability in the region.179

2. The EBRD's Negative Pledge Policy

One typical and very significant provision in the loan agreements of development banks is a negative pledge clause.180 A negative pledge clause provides, in essence, that although loans to the public sector will be unsecured, the borrower cannot provide any subsequent lender better security without allowing the Bank to "share equally and rateably" in the security.181 This clause could significantly

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178 See Weber, supra note 3, at 27.
179 Id.
180 See Hurlock, supra note 171, at 346.
181 See id. The EBRD's standard negative pledge clause is as follows:

(a) If the Borrower or the Guarantor is a member, the member undertakes to ensure that no other external debt of the member shall have priority over the Loan in the allocation, realisation or distribution of foreign exchange held under the control or for the benefit of the member. If any lien shall be created on any public assets as security for any external debt which will or might result in a priority for the benefit of the creditor of such external debt in the allocation, realisation or distribution of foreign exchange, such lien shall, unless the Bank shall otherwise agree, ipso facto, and at no cost to the Bank, equally and rateably secure the principal of, and interest and other charges on, the Loan, and the member, in creating or permitting the creation of such lien, shall make express provision to that effect, provided, however, that if for any constitutional or other legal reason such provision cannot be made with respect to any lien created on assets of any of its political or administrative subdivisions, the member shall promptly and at no cost to the Bank secure the principal of, and interest and other charges on, the Loan by an equivalent lien on other public assets satisfactory to the Bank.

(b) If the Borrower is not a member, the Borrower undertakes that, except as the Bank shall otherwise agree:

(i) if the Borrower creates any lien on any of its assets as security for any debt, such lien will equally and rateably secure the payment of the principal amount of, and interest and other charges on, the Loan, and in the creation of any such lien express provision will be made to that effect, at no cost to the Bank; and
CONCLUSION

Although the EBRD is a remarkable institution, it is too early to determine the potential impact of the EBRD in Central and Eastern Europe. Its private sector mandate and its fostering of multiparty democracy may have an effect far beyond the specific projects that it undertakes. The Bank, with its approach to development that requires political as well as economic freedom, may present the world with a positive model for sustainable development.