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The EBRD: Redundant, or an Important Actor in the Transformation of Eastern Europe?

Now in its second year of operation, the European Bank for Reconstruction and Development was the first new institution set up by the West to cope with the historical challenge of helping to transform the centrally planned economies of Eastern Europe into market economies. Strongly criticized for its lack of funds and its redundant profile when compared to the World Bank and the European Investment Bank, the "European Bank" is still struggling to assume an independent role in the transformation process and remains a controversial institution.

Since 1989 the radical changes and reforms in Central and Eastern Europe have taken place against an extremely unfavorable background. Large budget and balance-of-payments deficits partly due to a heavy burden of external debt, negative economic growth, the collapse of intra-regional trade and regional markets, external shocks due to the Soviet decision to price oil exports at world market prices aggravated by the Gulf conflict – all helped to send Eastern Europe into an economic slump that can only be compared to a depression on the scale of the 1930s in the West.

Not surprisingly, under these circumstances of fundamental short-term shocks and profound and far-reaching long-term investment and restructuring needs, private finance from abroad has been unavailable or insufficient.[1] Risk and insecurity are high while political transformation appears to be far from being stable with rising unemployment and the worsening of the social and general living conditions of the people. Therefore, much of the initial cushioning had to be provided for by the international financial institutions (IFIs), such as the World Bank, the IMF, or – on the European side – the European Community with the European Investment Bank (EIB) and the European Commission's coordinating role in the PHARE-program of the G-24.[2] Nevertheless, Western aid to Eastern Europe has so far mainly consisted of bilateral aid with Germany being in a strong lead. Due to the difficulties with the unification process in Germany, however, even the Germans are now much more cautious. They increasingly insist on a spreading of the cost. Given budget constraints and domestic priorities, it seems likely that Western governments will focus more on multilateral support for Eastern Europe in the near future.

Within the multilateral context, the European Bank for Reconstruction and Development (EBRD) that officially began to operate on April 15, 1991 has had the hardest time defending its existence and defining its role in the transformation process in Eastern Europe. This new bank, with the task of rebuilding the shattered economies of Central and Eastern Europe, has been praised by its first president, Frenchman Jacques Attali, as "the first post-cold war institution ... totally new in terms of its task and its operational tools"[3] while its strongest critics have concluded that if it "did not exist, it would not need inventing."[4]

This paper looks at the controversy over the creation of the EBRD and analyzes the first steps and orientations of this new bank. Why was it created, is it needed at all, what do its first steps reveal and will it find a permanent role in relation to other IFIs?

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[1] Cf. K.-H. Kleine, E. Thien: The Role of the IMF and the World Bank in the former Eastern Bloc Countries, in: INTERECONOMICS, January/February 1992, p. 20.

[2] During the G-7 summit in Paris in July 1989, it was decided to coordinate bilateral aid to Poland and Hungary. A larger group, the G-24 made up of the EC and EFTA countries, Canada, the USA, Japan, Australia, New Zealand and Turkey, was set up while the Commission of the EC was given the task of coordinator. In September 1989, the "Poland/Hungary Aid for Restructuring of Economies" (PHARE) program stated the priorities for Western aid to Eastern Europe.

[3] Speech by the President of the EBRD delivered on 22nd September 1990, at the Bretton Woods Committee in Washington DC, p. 1.

[4] The Economist, quoted in J.A. Blinken: Jacques of All Trades, in: The New York Times Magazine, 13 October 1991, p. 47.

The Difficult Creation Process

Jacques Attali, close advisor to the French President, François Mitterrand, has been identified as the spiritual father of the new bank.[5] In the fall of 1989, against the backdrop of radical change in Eastern Europe, he convinced the French President that the West had to act in order to sustain the region's break with communism. Accepting the view that the current problems in Eastern Europe constituted not only a liquidity crisis but a large-scale and long-term solvency crisis and that the transformation would probably take decades, large financial flows would have to be channelled via development institutions. As long as private investment was not sufficiently forthcoming, these institutions could provide much-needed technical advice and expertise while monitoring the progress made in the transition.

If one were to attach democratic and economic conditionality (respect for human rights, a true beginning or return to democracy with free elections and the introduction of multi-party systems, the rule of law, the development of market economies) to the financial support, the transition would be set to develop in the Western interest. Creating a new multilateral organization would mobilize additional funds and allow for a common and specific European approach to the problem, thereby channelling and partly controlling the economic and financial might of single members, such as Germany. It was argued that existing IFIs were not flexible enough and that they were located too far away from where the problems really were.[6]

After initial informal discussions within the EC, the official initiative for the creation of the EBRD was accepted by the EC heads of government at the European Council meeting in December 1989. The new organization was conceived as European in its basic character and broadly international in its membership, including also the non-European members of the G-24, the seven East European countries, Yugoslavia, Malta, Cyprus, Liechtenstein, Mexico, South Korea, Israel, Egypt and Morocco. Stressing the European component of the idea, the EC and the EIB were also included while it was agreed that the EC would control the accumulated majority of shares in the new bank. However, after this start it took more than a year until the inauguration of the bank in April 1991, despite the fact that most of the controversial issues were already settled by May 1990. And yet, this is still a record time for the creation of an international organization.

Nevertheless, as with any IFI set up in the past, controversy arose over several points: amount of capital, location, decision-making and control, scope and objectives, and, not least, personnel. The dividing line over many of these points was between France, Germany and Italy on the one hand and the USA and the UK on the other.

While France had initially advocated a much larger capital with Britain taking the opposite view, the issue was finally settled with an agreement over a capital of ECU 10 billion ($12 billion). Arguably not much when compared to the capital of other IFIs, yet – due to the denomination in ECU – stressing the European dimension. Some of the British resentment against the bank was appeased by the decision to locate the headquarters in London. US opposition focused mainly on the inclusion of the Soviet Union. It was argued that the Soviet reform process was

[5] Cf. P. A. Menkveld: Origin and Role of the European Bank for Reconstruction and Development, London and Boston: Graham & Trotman 1991.

[6] Cf. the arguments put forward by EBRD vice-president, Mario Sarcinelli, Frankfurter Allgemeine Zeitung, 12 December 1991.

much too slow and that this potential recipient of loans would easily tend to crowd out others. Nevertheless, when the US came to realize that the EBRD would not be stopped if Washington refused to join,[7] the US administration settled for the position of the largest single shareholder with 10% and saw to it that the Soviet borrowing was limited to its 6% share, i. e. a total of $ 216 million over the first three years.[8] With respect to decision-making and control, the US opposed the attempts made by Jacques Attali – designated chairman after the compromise with the location of the headquarters – to fully control all major issues in the new bank. In the final settlement of the question, Attali has to cope with an American as second-in-command. He must also deal with a 23-member board of directors that must approve projects.[9]

Despite the many compromises, when it comes to fundamental conflict, the EC (with an accumulated 51 % of the shares) will be able to get its way. The EBRD holds the potential of a specifically European answer to the problems in the Eastern part of the continent.

In sum, the creation process is largely a reflection of the vacuum of ideas at the end of 1989 that Attali's idea was able to fill. In addition, the new bank benefitted from a very skillful negotiation strategy of the French who went for EC endorsement of their plan before giving in to compromise during the final set-up when dealing with the opponents of the idea.

Objectives of the New Bank

While being similar in many respects to other IFIs, the EBRD comes with a few explicit features that set this bank apart: the commitment to political transformation in the receiving countries, the majority of resources devoted to the private sector, and the commitment in the agreement "to promote in the full range of its activities environmentally sound and sustainable development."[10] However, these "new" elements written into the EBRD's agreements are mostly a reflection of the mainstream ideas on development at the time when they were formulated. It remains to be seen whether having agreed upon these features in written form will really make a difference to the activities of the bank.

Political conditionality and respect for the principles of multiparty democracy, pluralism, and market economics were already included in the PHARE-program of the G-24. Other development agencies, such as the World Bank, have already proved that violation of human rights can lead to the suspension of loans. The real test for the EBRD on this issue is still to come, probably sooner than had initially been hoped for. So far, project proposals from Yugoslavia have been turned down and Attali insists upon a strong political commitment that would exclude, for example, an EBRD loan along the "Chilean way" to a dictatorship following liberal market strategies.[11]

The 60 % commitment of loans to private sector projects or sectors being privatized that was written into the EBRD's agreements due to US pressure, also points to the similarity with the World Bank Group. The EBRD is taking on a job in the private sector similar to the one that the International Finance Corporation (IFC) has been pursuing in Hungary and Poland even before 1989. With the remaining 40% of its activities, the new bank is also somewhat copying the activities of the World Bank in the public sector.

As to the environmental orientation, this goal is phrased in the general way that any other international organization is nowadays eager to endorse. Governments and NGOs will still have to see to it that the project policies of the EBRD really permit sustainable development.[12] If a look at the objectives reveals that the new bank is still struggling to find an independent role what results do its first steps and announcements show?

Strategies And First Operations

In its first statement of priorities and policies, issued in May 1991, the EBRD is taking a moderate position commensurate with its own limitations.[13] Initially, it will co-operate and co-finance projects with other multilateral institutions such as the World Bank and the EIB, thereby also reflecting the fact that large parts of its personnel of some 350 experts have been recruited from these organizations. However, with the growth of its own

[7] Cf. S. Sparks: The European Bank for Reconstruction and Development, in: Policy Focus – Overseas Development Council, No. 3, 1990, p. 9.

[8] Cf. Paragraph 4 of Article 8 of the Agreement on the EBRD and the letter of the head of the Soviet delegation, both in I. F. L. Shihata: The European Bank for Reconstruction and Development – A Comparative Analysis of the Constituent Agreement, London/Dordrecht/Boston: Graham & Trotman 1990, pp. 117-18 and 164-65.

[9] The Economist, 16 March 1991, p. 28, was quick to comment: "The full-time board of 23 highly paid directors plus staff will absorb a quarter of the budget of this supposedly profit-making bank."

[10] Paragraph 1, section 7, of Article 2 of the Agreement; cf. I. F. L. Shihata, op. cit., p. 111.

[11] Cf. interview with Attali in: Le Monde, 24 April 1991.

[12] Cf. D. Reed: The European Bank For Reconstruction And Development: An Environmental Opportunity, World Wide Fund for Nature – International Multilateral Development Bank Program, Washington, DC, October 1990, pp. 1-47.

[13] Cf. European Bank for Reconstruction and Development: Operational Challenges and Priorities: Initial Orientations, London, April 1991; and Financial Times, 7 May 1991.

experience and expertise, the EBRD plans to respond to country needs progressively. The initial focus will be on such areas as privatization and economic restructuring with programs and activities that support:

☐ the creation and strengthening of infrastructure, including regulatory infrastructure and improved energy, transport, and telecommunications;

☐ privatization;

☐ reform of the financial sector, including development of capital markets and privatization of commercial banks;

☐ development of a productive, competitive private sector, including small and medium-sized companies in industry, agriculture and services;

☐ restructuring the region's industrial sectors to put them on a competitive footing;

☐ encouraging foreign direct investment, and

☐ cleaning up the environment.

In more concrete terms, the EBRD had received some 1,200 project proposals by the end of 1991 out of which it selected 8 projects in the private sector and 4 projects in the public domain, mobilizing some DM 750 million. However, as stated above, most of these projects were carried out in close cooperation with the World Bank, the EIB, and other bilateral credit agencies, whereby the EBRD was often following the lead of the World Bank.

Table 1

EBRD Loans to Central and Eastern European States (as of end of 1991)

(in DM million)

No.	Amount	Country	Type of Activity
Merchant Bank:			
1	9.6	Hungary	Privatized packaging company Petőfi Nyonda
2	4.8	Hungary	Private computer company
3	16.0	Czecho-slovakia	Fund for the privatization of small and medium-sized enterprises (CZIC)
4	20.0	CIS/Russia	Joint-venture for oil-exploration in Siberia
5	3.5	Poland	Joint-venture for the construction of cold stores
6	96.0	Poland	Joint-venture for telecommunications network
7	10.7	Poland	Joint-venture in the food processing industry
8	46.0	Romania	Energy company
Development Bank:			
1	80.0	Poland	Energy conservation and heat supply reconstruction
2	284.0	Romania	National telephone company
3	185.0	Hungary	National telephone company
4	10.0	CIS/Russia	Digital network Moscow

Source: EBRD.

Table 1 illustrates that the bulk of the EBRD's activities has so far been concentrated on the three reformatory states in Central Europe. In its second year, the bank wants to more than double its commitments. It is looking into 145 projects out of which 30 to 40 will probably be finalized.

In addition, the bank has accepted the three Baltic states as new members, it has decided to lift the restraint from Article 8 of its Agreement in order to now treat all CIS members like any other Eastern European member, and it is preparing for the membership applications of the new nation states of the CIS. While an enlargement of the 6% share of the former Soviet Union will have to wait until the next round of rise in capital, it seems likely that Russia will receive a 3.6% share, the Ukraine will have to settle with 1.4%, with the remaining 1% going to all other former republics.[14] Meanwhile, the EBRD had participated in the formulation of the short-term action plan for the Soviet Union published under the auspices of the IMF at the beginning of 1991.[15] The new bank has also formulated country strategies for Hungary, Czechoslovakia, Poland, Romania, Bulgaria, and Albania and it is going to monitor the transformation process in every Eastern European country by publishing the respective annual reports. By the time of its first annual meeting, April 13 and 14 in Budapest, the new bank had established permanent offices in 8 countries in Eastern Europe. Hopes are high that these annual meetings will develop into an important forum bringing together bankers, entrepreneurs and government officials in a way that allows for a constructive communication over the many problems in the transformation process. This role of forum or facilitator of dialogue appears to be a future strength of the EBRD.

A Permanent Niche for the EBRD?

Despite its many initial steps and the ever active rhetoric of its president, the EBRD is still struggling to assume a clearly defined and widely accepted role. Given the so far unchallenged lead of the World Bank and the IFC in the design, evaluation and implementation of projects in Eastern Europe, one question is continually asked by the EBRD's critics. What is the function of this new institution if it does not come up with anything new?

It is clear from the first activities and assertions of the bank that it is primarily trying to make a difference in the field of the IFC and the EIB. While its overall financial

[14] Cf. Le Monde, 30 January 1992.

[15] Cf. IMF et al.: A Study of the Soviet Union, 3 vol., Paris, February 1991.

contribution to the transformation process will remain relatively small for the time being – a total of some $ 40 billion for Eastern Europe will be mobilized by all IFIs by the end of 1995 with a share of some 15% from the EBRD[16] – the new bank is in the privileged position of being able to focus all support on the area. The IFC had to distribute its $ 1.5 billion for fiscal year 1991 over a much larger number of potential recipients, East and South. It will not be able to spend more than $ 500 million in loans and equity interests in private sector activities in Central and Eastern Europe for the period 1991 to 1993. Nevertheless, the voices from the Southern hemisphere are already many that the World Bank ought to concentrate on their needs leaving Eastern Europe to others. Similarly, the EIB is constantly reminded of its task in the periphery of the EC. Therefore, with growing expertise and knowledge about the terrain, the EBRD is ideally positioned to gradually emerge as the leading facilitator of privatization in Eastern Europe while also contributing to create the necessary infrastructure.

Instead of concentrating on this task, the EBRD feeds into the arguments of its critics by making claims and assertions – mainly through the independent and mercurial voice of its president – that often fail to stand up to closer scrutiny. Claiming in public the lack of expertise of the other IFIs[17] while following their lead on one's own day-to-day operations shows a fundamental lack of sovereignty. It is equally misleading to insist on a unique role as a catalyst for private investment and as a strong multiplier when all other IFIs always call upon other lenders and private investors to follow their lead and invest more. The IFC, e.g., has a record of 6 dollars out of other financial resources being mobilized for every dollar of its own.[18]

A Controversial President

President Attali's visions tend to reach far beyond the more mundane operations of the new bank. His talk is often of the bank as "the economic institution of the new pan-European architecture" leading to the realization "of the European dream about a united continent."[19] His special interest is in pan-European projects such as the clean-up of the Baltic sea or the Danube river, and in a European energy plan[20] – projects which have not yet materialized. His projects stress political symbolism rather than the immediate task of the bank at hand.

Attali's restlessness is somewhat explained by the fact that so far sound and profitable projects for privatization at market interest rates are few during these days of economic depression in Eastern Europe, as witnessed by the high number of project proposals that fell through. All IFIs at work in Eastern Europe operate on the assumption of imperfections in the capital market and yet, even with advice and technical coordination for free, there is an intense competition among donors and even private investors over the few lending opportunities that look promising under the given bleak circumstances. Eastern Europe appears to be much less ripe for investment than all IFIs had hoped for. Instead of sticking to the difficult task at hand and counting on the gradual emergence as the key lender in the privatization process, President Attali is attempting to move the focus of the bank into new areas. He has claimed "that the bank was the main lending and advisory body for the region and that other institutions should move over."[21] Given the limited number of sound projects, he has also sought to refocus the bank's role on the training of managerial capacity and on technical assistance,[22] thereby trying to take over the coordination role of the European Commission in the G-24. Not surprisingly, these overtures have been met with strong resistance. Since the EBRD's proper funds are designated for credits, it must seek additional funds for new objectives. Fresh money has only been forthcoming on a minor scale. However, President Attali does not appear to be the man who will stop trying to expand the role of his organization. If other tasks continue to be dominated by other players and if the EBRD fails to shove them aside, the brief history of Attali's leadership seems to be a strong indicator that he will try again, exploring every new opportunity that might arise.

While the EBRD is today still far from being an important actor in the transformation of Eastern Europe, the unusual and often provocative leadership style of its president has managed to keep the new bank on the agenda of its member countries. The bank will ultimately have assumed its role when it manages to close the gap between the visions of its president and the more down-to-earth tasks of its present operations. It still has the potential to become an important actor in the privatization and transformation process in Eastern Europe.

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[16] Cf. for these figures, K. Schröder: Westliche Finanzhilfen für Reformen in Osteuropa – Bedingungen und Risiken, in: Außenpolitik, Vol. 42, 4th quarter, 1991, p. 333. With the IMF and World Bank membership of almost all CIS member countries envisaged for the end of April 1992, these figures will, of course, go up.

[17] Cf. EBRD vice-president, Mario Sarcinelli, in: Frankfurter Allgemeine Zeitung, 12 December 1991.

[18] Cf. K.-H. Kleine, E. Thien, op. cit., p. 27.

[19] Interview with Attali, Wirtschaftswoche, 12 April 1991 (author's translation).

[20] Cf. the interview with Attali, Le Monde, 24 April 1991.

[21] According to: The Economist, 10 August 1991, p. 21.

[22] Cf. for the justification of this new focus on the human factor, Y.-M. Laulan: BERD, Mode d'emploi, in: Politique Internationale, No. 53, autumn 1991, p. 120.