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Eastern Europe and the European Bank for Reconstruction and Development: New Policies and Programs for Business Development**

The European Bank for Reconstruction and Development is a still young international institution. Yet it has gotten off to a remarkably fast start and accomplished a great deal since it began operations in April 1991.

As is evident from your program at this meeting, many of the interests and concerns of the International Law Section are relevant to the work of the Bank in assisting the former Communist countries of Central and Eastern Europe in their transition to market economies and democracy. Law plays a key role in creating the conditions for a sound market economy. It creates the institutional framework, the essential infrastructure, for the peaceful interaction of economic agents. It helps to establish the political and social atmosphere, the climate of confidence congenial to the businessman (in the words of Keynes), on which economic prosperity depends. Unless the rule of law prevails, investors will shy away and the creative energies of entrepreneurs will not be released.

The transformation of centrally planned economies, in which private economic activity had effectively disappeared, into private sector-oriented market economies has presented an unprecedented challenge. The Bank, having been formed to address the special needs of this transition process, therefore differs from other multilateral financial institutions in a number of ways.

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**The following remarks are an updated version of a speech Mr. Newburg delivered to the Section of International Law and Practice at the American Bar Association's Annual Meeting, New York, New York, August 10, 1993.

First, it is expressly committed by its charter[1] to the proposition that the successful transition of member countries to market-oriented economies is closely linked to democratic progress. Article 1 of the Agreement Establishing the Bank states that "the purpose of the Bank shall be to foster the transition towards open market-oriented economies . . . in the Central and Eastern European countries committed to and applying the principles of multiparty democracy, pluralism and market economics." Article 8 of the Agreement strengthens this purpose by providing that the Bank may operate only in countries "proceeding steadily in the transition towards market-oriented economies . . . and which apply . . . the principles set forth in Article 1 of the Agreement."

Second, the Bank, while having a specific private sector focus, combines under one roof the functions of a merchant or investment bank and the functions of a development bank. It finances the emerging private sector with equity investments and loans, and it finances public sector infrastructure necessary for the development of the private sector and the proper functioning of a market economy.

Third, the Bank has a specific environmental mandate. It is required to promote, in all of its activities, environmentally sound and sustainable development. All projects are subject to the scrutiny of the Bank's environmental appraisal group. In addition, the Bank participates in projects, such as the Danube River Basin Programme, aimed at cleaning up the environmental legacy of the Communist era.

Fourth, the Bank is the first international financial institution of which the countries of Eastern Europe and the former Soviet Union were founding members and represented on its board of directors.

When the Bank was inaugurated, the scope of its mandate covered six countries of Central and Eastern Europe: Czechoslovakia, Hungary, and Poland (the three "Visegrad" countries) and Bulgaria, Romania, and Yugoslavia. The USSR was also included, but the Bank's financing there was initially severely constrained, being limited by a special provision in the Agreement Establishing the Bank to the amount of that country's cash subscription to the Bank's capital stock. The dissolution of the Soviet Union, the break-up of Yugoslavia, and the split of Czechoslovakia brought, within two years of the Bank's inauguration, the number of member countries in which the Bank operates to twenty-five, including all twelve republics of the former Soviet Union.

The complexity of the task being undertaken by the Bank is becoming more evident every day. Virtually all aspects of these societies—economic, political, legal, social, and cultural— require fundamental reform. One must remember

1. Agreement Establishing the European Bank for Reconstruction and Development, May 29, 1990, 29 I.L.M. 1077. Copies of the bylaws of the Bank and the rules of procedure of its boards of governors and directors may be obtained from: European Bank for Reconstruction and Development, One Exchange Square, London EC2A 2EH, U.K.

that in many of these countries there was no concept of private property, and profit was immoral. In addition to providing financing, therefore, the Bank has sought to assist in this reform process. The enormous demand in the region for technical assistance of all sorts is well known. To make grants for this purpose, the Bank has raised the equivalent of about $190 million in bilateral and multilateral technical assistance funds from twenty-nine donor countries and the European Community. Through the use of these technical cooperation funds, we have provided advice and training in a number of areas, such as privatization, and business and financial sector training. The Bank had made, as of December 31, 1993, firm commitments for 522 technical cooperation projects, at a value of over $155 million.

We have also sought to play a part in legal reform and training. Let me give you two current examples. Since the spring of 1992 the Office of General Counsel has been working, with the assistance of an international advisory board, on the development of a model law on secured transactions for the countries in which we operate. As the model law and an explanatory commentary near completion, there already appears to be a prospect that legislation based on this effort may be introduced in Hungary. The Bank will also work with its countries of operation to help them adopt and implement these new laws on security rights. We have also sponsored legal training courses for public officials at the Joint Vienna Institute, and further training for young law faculty from Central and Eastern European universities at the European University Institute.

In less than three years of operation the Bank has in fact been extraordinarily active in a complex and difficult working environment. The board of directors approved the Bank's first loan in July 1991. As of December 31, 1993—just two-and-a-half years later—the Bank had signed 112 projects in nineteen countries representing a total Bank financing commitment of over $3.1 billion, and involving project costs of over $9.4 billion. This is a record that no other international financial institution matched in its early years.

About 62 percent of these projects are in the private sector, including equity investments of over $212 million. However, as the average public sector infrastructure project tends to be about twice the size of the average private sector project, the Bank has had to struggle to meet the target, set when the Agreement was negotiated in 1990, of providing not less than 60 percent of the aggregate amount of its financing to the private sector. As lawyers are well aware, a small multiparty joint venture frequently requires more time and effort than a hundred million dollar state-guaranteed loan.

A glance through the Bank's investment portfolio shows a diversity of projects, some of them quite innovative. For example:

- Major telecommunications projects have been funded in nine countries of the region, and we are currently working on such projects in six more countries.

- In the food industry, we have funded twenty-three projects, including an equity investment in the first sugar refinery to be privatized in the Czech Republic.
- In the oil and gas sector, the board has approved nine projects including a $175 million loan to Russia to improve oil production in western Siberia, aimed at tripling production in the Tyumen region.
- In the financial sector, which has become an increasing priority for the Bank, the board has approved eighteen projects. These include an equity stake in Romania's first western-style investment bank; an equity investment in Poland's first major commercial bank privatization; and an equity investment in the Russian Project Finance Bank.

The Bank looks for new and innovative solutions to the problems these countries face. We are trying to develop nonrecourse project financing techniques for infrastructure projects that will reduce reliance on government borrowing or guarantees and arrest the build-up of sovereign external indebtedness. The Bank has concluded an agreement to finance the first transport sector Build-Operate-Transfer (BOT) operation in Central and Eastern Europe, with a $150 million loan to the concessionaire of a major toll road linking Budapest and Vienna and repayable from toll revenues. This deal is an example of how public/private sector partnerships can be used in countries where the burden of infrastructure financing is too large to be placed solely on the public purse.

The Bank has also been a leader in the field of nuclear safety. In March of 1993 the Bank set up, at the request of the "G-7" group of countries, a nuclear safety account, a fund devoted to the most urgent safety improvements in Soviet-built nuclear power reactors across the region. Over $130 million has been pledged by twelve governments and the European Community. A first grant of about $30 million has already been approved to upgrade the safety of the Kozloduy power plant in Bulgaria and disbursements have already begun for engineering work on the project. As part of the deal, we were able to obtain a Bulgarian commitment to phase out, and eventually shut down, the older, most dangerous units. A similar project at the Ignalina nuclear power plant in Lithuania was signed in 1994 involving a grant amount over $35 million.

One of the areas in which innovative techniques are most needed is in the financing of small and medium-size enterprises. As experience in many other countries has shown, this sector plays a vital role in the revitalization of an economy. It is a sector, however, which an institution such as the bank has difficulty in reaching, since for practical reasons it cannot directly engage in the business of making small loans. The key is to find funding mechanisms whereby we can help deliver relatively small sums to entrepreneurs. This is no easy task, but the Bank is seeking to become more involved in the earlier stages of business development and to find channels of providing finance to small and medium-size business through financial intermediaries.

The G-7 countries, in connection with their program to assist Russia, have asked the Bank to set up a $300 million fund for financing small business in Russia, half of which is to be provided by the G-7 and other donor countries. The Bank is now implementing a $10 million pilot project. The objective is to use local financial intermediaries, such as regional investment companies, to make equity investments, and small business finance companies to provide micro-credits.

As you can see, much has been accomplished by the Bank in a short time. The Bank's results are sometimes criticized because the level of disbursement remains low. This fails to take into account that we finance only projects and do not make balance of payments or "fast disbursing" loans. Disbursements are made only against project expenditures, and the level of disbursements thus depends on the pace of project implementation. In public sector projects, compliance with international procurement procedures frequently takes a great deal of time, especially in countries that have little, if any, experience with competitive bidding and international procurement.

I should like to end today by noting the U.S. involvement with the Bank. Although a majority of the shares and voting power of the Bank is held by European countries and the European Community countries and institutions, fifty-seven countries throughout the world are now members. The United States is the largest single shareholder, with 10 percent of the Bank's ten billion ECU share capital. It has a seat on the board of directors. There is a strong U.S. representation on the staff: the first vice president is an American and almost 12 percent of the Bank's senior staff are U.S. nationals.

As you may know, various congressional committees criticized the Bank in 1993 and recommended no funding for the U.S. stock subscription payment due in fiscal 1994. I believe that this criticism to a large extent reflected inadequate familiarity with the Bank's activities.

Many U.S. companies have found the Bank a source of debt and equity financing for their joint ventures and other projects in Central and Eastern Europe. Of fifty-eight merchant banking projects approved by the Bank's board of directors as of June 30, 1993, twenty-six involved U.S. companies, and many other projects with U.S. participants are in the pipeline. United States companies have also been awarded a significant number of contracts for projects financed by the Bank. As of June 1993, 23 percent in number (and over 12 percent in value) of all contracts awarded for Bank-financed public sector projects had gone to U.S. companies. Finally, many consulting contracts have been with U.S. firms. About 13 percent in number (and over 9 percent in value) of all such contracts financed by the Bank were with U.S.-based consultants. We hope also that U.S. banks will increasingly cofinance the Bank's deals, as the perceived political risk in the region declines.

American involvement in the EBRD is a strong one. It is a relationship indicative of the close U.S. interest in the reconstruction of Eastern Europe—an interest that has loomed large as recent threats to regional security and stability have grown. This is not an easy process. It will take decades to complete, and the international community has a crucial role to play. The EBRD is only one element of this international effort, but I believe that it is proving itself to be an integral element.