1. INTRODUCTION

The end of the Cold War has brought many new challenges to the world. Yet, the post-Cold War era possesses a few characteristics which are strangely reminiscent of times preceding World War II. Prior to World War II, and before the rise of communism in Central and Eastern Europe, the West was viewed as a potential source of the means for modernization and technological progress. Cooperation with the West was an important part of the economic policies of Peter the Great as well as Lenin. “Look to the West” policies were also followed in Japan, during the Meiji era, and were attempted by late 19th century Qing dynastic rulers and the Republican government in China. The purely political and economic characteristics of the West,
such as multiparty democracy and capitalism, were not influential during this period, however, since the Communist states, following Marxist doctrine, explicitly rejected the market and democracy as the ultimate ordering principles for a civil society. Additionally, democracy was not vigorously pursued even in some Western countries.

The Cold War radically hindered and altered the engagement between the East and the West in fundamental ways. The result, in Central and Eastern Europe, was a stark division between the Soviet and Western spheres of influence. The Bretton Woods institutions, the International Monetary Fund (“IMF” or “Fund”) and the International Bank for Reconstruction and Development (“World Bank”) came into existence with charters that forbade the involvement or consideration of political issues in their operations. The rise of the Soviet bloc frustrated the Marshall Plan for a greater economically unified Europe. Europe, in turn, divided into two economic hegemonies — the European Community in the West and the Council for Mutual Economic Assistance in the East.

In the contemporary post-Cold War period, the states in the former sphere of Soviet influence are radically transforming, both politically and economically. These emerging states are in various stages of privatization, of junking their inefficient planned economic structures in favor of market-oriented economic systems. On the political level, they are attempting to embrace democracy as a model for political development. The political upheavals in these countries are, in substantial part, due to the failure of the command economic structure. Such fundamental transformations require outside financing because there have been no contemporary, effective banking systems in these countries in recent history. In their transition from socialism, these

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4 See Grzybowski, supra note 1, at 284.
6 See Grzybowski, supra note 1, at 284-85.
states need not only development, but reconstruction as well.\textsuperscript{8}

At the time of these changes, several positive trends appear to be emerging from the rubble of the Cold War. Significant among these trends is an emphasis on, and optimism among states for, multilateral action.\textsuperscript{9} This focus on multilateralism manifests itself in the economic sphere, with, for example, the creation of the World Trade Organization, and in the political sphere, with United Nations Security Council action in Somalia, Haiti, Rwanda, Bosnia-Herzegovina, and elsewhere. A second significant trend, at least in Europe, is the emergence of a norm of democratic public order, an emerging right of peoples to democratic governance.\textsuperscript{10} This norm or right has significant ramifications for peace, as international relations theorists have demonstrated a substantial correlation between the existence of democracy and peace.\textsuperscript{11} A third trend, apparent in development economics, is the trend towards market-oriented economics, or “laissez faire with a human face,” as the preferred approach for sustainable economic development.\textsuperscript{12}

The European Bank for Reconstruction and Development (“EBRD” or “Bank”) is a significant manifestation of these

\textsuperscript{8} See id.
\textsuperscript{11} Democratic governments rarely start wars. See generally R. J. RUMMEL, DEATH BY GOVERNMENT (1994); BRUCE RUSSETT, GRASPING THE DEMOCRATIC PEACE: PRINCIPLES FOR A POST-COLD WAR WORLD (1993).
three trends, and is itself a promoter of them. The EBRD’s Articles of Agreement explicitly require that it only provide financing in or to states which have embraced multiparty democracy and market-oriented economics. The purpose of the Bank is to promote the development and reconstruction of the countries of Central and Eastern Europe, the Russian Federation, and the newly independent states of the former Soviet Union. Because its charter is based in part on political conditionality, a concept forbid-
den to the World Bank and other multilateral financial institutions, the EBRD is a unique multilateral institution. The overt political nature of the EBRD's mandate is a radical departure — a never-before-used approach — in multilateral development financing institutions. Indeed, the formation of the Bank has been hailed as remarkable and described as both “the first post-cold war institution,” and the “first institution of the new world order.” The Bank is an apparent product of current thinking in development economics with its focus on small and medium enterprises, and its view that private enterprise development and the entrepreneur are the engines of development.

From a financial or commercial perspective, the EBRD is intended to deal with critical capital shortfalls that eligible countries have experienced during their transitions from socialism. Without capital, the embryonic private sectors of these transitional countries would die an early death. Commercial banks, however, are reluctant to invest substantial sums in these countries because of, among other

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16 See Articles of Agreement of the International Bank for Reconstruction and Development, supra note 5, art. IV, 60 Stat. at 1449, 2 U.N.T.S. at 158. The Articles of Agreement of the World Bank provide as follows:

The Bank and its officers shall not interfere in the political affairs of any member; nor shall they be influenced in their decisions by the political character of the member or members concerned. Only economic considerations shall be relevant to their decisions, and these considerations shall be weighed impartially in order to achieve the purposes stated in Article I.

Id.; see also Jonathan Cahn, Challenging the New Imperial Authority: The World Bank and the Democratization of Development, 6 HARV. HUM. RTS. J. 159, 163 (1993) (arguing that the World Bank violates this provision).


reasons, their adverse experiences with sovereign risk in the Latin American debt crisis,\textsuperscript{20} the tendency of their lending to relate significantly to the activities of their key corporate clients,\textsuperscript{21} and the lack of commercial bank confidence in the creditworthiness of the emerging governments and their privatizing or newly privatized enterprises.\textsuperscript{22} Commercial bank confidence depends heavily on political, legal, and economic reform in the countries in question.\textsuperscript{23}

The EBRD was created in part to alleviate these and other obstacles to the infusion of necessary capital into transitional countries. The EBRD views itself as a catalyst for private capital inflows into its borrowing countries.\textsuperscript{24} The Bank has been very busy in its few years of existence, although, until recently, it fell short on actual disbursements of funds.\textsuperscript{25} It appears, however, that the trend for


\textsuperscript{22} See id.

\textsuperscript{23} See id.

\textsuperscript{24} See EUROPEAN BANK FOR RECONSTRUCTION AND DEVELOPMENT, 1993 ANNUAL REPORT 13 (1994) [hereinafter 1993 ANNUAL REPORT].

\textsuperscript{25} See infra note 26; 1993 ANNUAL REPORT, supra note 24, at 44. Given the Bank's recent creation, the Bank disbursed relatively little of its committed or approved financing, at least until 1994. As of the end of 1993, total board-approved projects amounted to over ECU 3.7 billion. \textit{Id.} For a definition of ECU, see infra note 34. Disbursements in 1992 and 1993 together, however, totaled only approximately ECU 675 million. 1993 ANNUAL REPORT, supra note 24, at 44. In fact, in 1992, the Bank disbursed only about ECU 126 million. \textit{Id.} In 1992, only six countries benefited from disbursements. \textit{Id.} In 1993, projects in virtually all countries served by the EBRD received some form of disbursements, with Hungary and the Russian Federation topping the list. \textit{Id.}
disbursements is increasing.\textsuperscript{26} With the Bank’s initial capitalization set at ECU 10 billion, the Bank maintains that it will fully commit its capital base by the end of 1997.\textsuperscript{27}

Ultimately, the Bank emerged from a synthesis of philosophies and power bases,\textsuperscript{28} with its main characteristics negotiated as follows:

1) Environmental conditionality. The Bank is required by its Articles of Agreement to promote and take into account environmental concerns and the concept of sustain-

\textsuperscript{26} The Bank got off to a slow start, in that its loan activities initially were somewhat 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 \textit{EUROPEAN BANK FOR RECONSTRUCTION AND DEVELOPMENT, QUARTERLY FINANCIAL REPORT} 2 (Sept. 1994). Since its founding in April, 1991, the Bank has created a portfolio of 252 projects, with total funds reaching ECU 6.9 billion in 1994. See Anthony Robinson, \textit{European Bank Eyes Future Funding}, \textit{FIN. TIMES}, Apr. 8, 1995, at 2. In 1994, the Bank’s loan and equity portfolio increased by 74%, for a total value of ECU 4.4 billion in committed financing. See \textit{EBRD to Consider Capital Increase to Meet Future Financing Requirements}, 12 \textit{Int’l Trade Rep.} (BNA) 703 (Apr. 19, 1995) [hereinafter \textit{EBRD to Consider Capital Increase}]. The Bank committed to ECU 1.9 billion in 1994. \textit{Id.} Also in 1994, disbursements increased to ECU 591 million, almost 60% greater than in 1993. \textit{Id.} In 1994, the EBRD disbursed more funds than in any other previous year. See Robinson, \textit{supra}, at 2. Over 80% of the Bank’s financing has been in the form of loans. See 1993 \textit{ANNUAL REPORT}, \textit{supra} note 24, at 13. The telecommunications and financial institutions sectors have comprised the largest elements of the Bank’s portfolio in terms of value, while the financial institutions, manufacturing, and agriculture sectors have comprised the largest recipients in terms of the number of projects. See 1993 \textit{ANNUAL REPORT}, \textit{supra} note 24, at 13. Although the Bank has approved projects for 24 of the 25 countries in which it operates, see \textit{EBRD to Consider Capital Increase}, \textit{supra}, at 703, the Bank’s activities have been most intensely focused in six countries—Poland, Hungary, the Russian Federation, Romania, the Czech Republic, and Slovakia, see 1993 \textit{ANNUAL REPORT}, \textit{supra} note 24, at 13-14. This geographical concentration may make sense in terms of establishing a good track record for the Bank, and may at least in part be caused by limitations in the Bank’s Articles of Agreement. See \textit{id.}; \textit{The Lex Column: EBRD}, \textit{FIN. TIMES}, Apr. 7, 1995, at 14. From a development perspective, however, the countries that need capital the most may be deprived by this approach. See \textit{id.} at 14.

\textsuperscript{27} See \textit{EBRD to Consider Capital Increase}, \textit{supra} note 26, at 703.

\textsuperscript{28} For a detailed discussion of the competing “maximalist,” “minimalist,” and “no aid” philosophies which accompanied the creation of the Bank, see Linarelli, \textit{supra} note 10, at 365-69.
2) 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.  

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 Bank combines the concept of a merchant or investment bank with that of a development bank. This private sector emphasis, however, is closely tied to the political conditionality of the Bank and could be a means of disqualifying projects in countries lacking significant private sectors or sufficient movement towards private sector development.

4) European majority. Although the United States is the single largest shareholder and exerted some influence during the creation of the Bank, the Bank is essentially a European institution. The majority of the Bank’s shares

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29 See infra section 2.1.
30 See infra section 2.2.
31 Agreement, supra note 13, art. 11(3), 29 I.L.M. at 1088. See infra text accompanying notes 122, 159, 202-03, 275, 279.
32 See infra section 3.1.
33 This point was suggested by Professor Peter Fox.
34 The Bank is European in character, with an American influence. See EUROPEAN BANK FOR RECONSTRUCTION AND DEVELOPMENT, CHAIRMAN’S REPORT ON THE AGREEMENT ESTABLISHING THE EUROPEAN BANK FOR RECONSTRUCTION AND DEVELOPMENT, EXPLANATORY NOTES, art. 4, reprinted in EUROPEAN BANK FOR RECONSTRUCTION AND DEVELOPMENT, BASIC DOCUMENTS OF THE EUROPEAN BANK FOR RECONSTRUCTION AND DEVELOPMENT 55 (hereinafter EXPLANATORY NOTES) (“The essentially European character of the Bank lent itself to the denomination of its original authorized capital stock in the European Currency Unit, the ECU.”). The Bank was conceived by President Francois Mitterrand of France and initially was proposed by him in October 1989. Its establishment was agreed upon within nine short months. See Easton & Rorer, supra note 17, at 527; see also Steven Weber, Origins of the European Bank for Reconstruction and Development, 48 INT’L ORG. 1, 13-31 (1994) (providing detailed history of the development of the Agreement which establishes the Bank).
are held by the members of the European Union ("EU"). The Bank's client states also are members of the Bank. The EU itself, and also the European Investment Bank ("EIB"), are shareholders. The United States holds only 10% of the shares of the Bank, and Japan holds 8.5%. This Article attempts a detailed description and analysis of the EBRD's activities and policies. Section 2 examines two significant policies which are collateral to the Bank's financing activities: the environmental and political conditionalities of the Bank. Section 3 provides a detailed analysis of the EBRD's policies that directly relate to financing. Section 4 examines the role of the Bank in the context of the EU and trade liberalization, and Section 5 provides some concluding observations.

The Agreement came into effect in March 1991 and the Bank began operations in April 1991. See 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 close to 400 from almost all its member countries."); Easton & Rorer, supra note 17, at 527. The Bank maintains its headquarters in London, although both of its Presidents have been French. See Easton & Rorer, supra note 17, at 527. The majority of the Bank's shareholders are the Member States that comprise the European Union. See MENKVELD, supra note 18, at 101-02. 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. See id.

See Initial Subscriptions to the Authorized Capital Stock for Prospective Members Which May Become Members in Accordance with Article 61, reprinted in Agreement, Annex A, supra note 13, 29 I.L.M. at 1102.

See IBRAHIM F.I. SHIHATA, THE EUROPEAN BANK FOR RECONSTRUCTION AND DEVELOPMENT: A COMPARATIVE ANALYSIS OF THE CONSTITUENT AGREEMENT 90 (1990) [hereinafter SHIHATA, A COMPARATIVE ANALYSIS]; William N. Gianaris, Weighted Voting in the International Monetary Fund and the World Bank, 14 FORDHAM INT'L L. J. 910, 930 (1990-91). Share interests in the Bank translate into voting strength in the Bank's Board of Governors, since the voting strength of each member is based on the member's capital contribution. See id. As explained by Mr. Shihata, "It is important to note however that resort to voting is rather uncommon in the [multilateral development banks] generally where most decisions are reached through consensus." SHIHATA, A COMPARATIVE ANALYSIS, supra, at 90.
The Articles of Agreement of the EBRD suggest a two-part framework for analysis of EBRD policies. First, there are collateral policies to which the Bank must adhere — policies that do not relate directly to the commercial or financial aspects of a Bank project. These collateral policies are the environmental and political mandates of the Bank's operations. 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. 37

2.1. Environmental Protection: Implementation of the EBRD's Environmental Mandate

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." 38 This is the first instance in which the charter of a development institution formally required that the institution take environmental issues into account in its activities. 39 The Bank interprets this provision to provide "a clear and proactive operational mandate . . . on environ-

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37 The dichotomy between direct and collateral policies is from JOHN CIBINIC, JR. & RALPH C. NASH, JR., FORMATION OF GOVERNMENT CONTRACTS 942 (2d ed. 1986). For a discussion of the detailed policies directly related to financing, see infra section 3.

38 Agreement, supra note 13, art. 2(1)(vii), 29 I.L.M. at 1084. The Explanatory Notes to the Articles of Agreement provide as follows concerning this 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.

EXPLANATORY NOTES, supra note 34, at 54.

mental protection and restoration." One authoritative
text describes the EBRD's concern for environmental issues
as "increasingly influencing" the activities of other mul-
tilateral developmental institutions.

The EBRD has actively implemented its environmental
mandate on a project-by-project basis through policies and
procedures such as environmental due diligence, specific
and general loan covenants, and supervision and monitoring
during, as well as after, project performance. The Bank
also provides assistance to countries in environmental law
and policy formation, promotes market-based environ-
mental infrastructure in the borrowing countries, supports
and conducts environmental studies and programs, and
promotes participatory pluralism on environmental matters
in the borrowing countries. The Bank, moreover,
leverages its environmental mandate by requiring its
financial intermediaries to adhere to the Bank's "Environment-
mental Procedures."

Since Bank financing is primarily accomplished through
loans, the Bank's Environmental Procedures seem to be
focused on loan agreements. The Procedures, however,
should be applied to equity financing as well. Indeed, the
rationale for applying the Procedures in a comprehensive
manner to equity financing arrangements is compelling,
because the Bank may, as a co-owner of a private entity,

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40 EUROPEAN BANK FOR RECONSTRUCTION AND DEVELOPMENT,
ENVIRONMENTAL MANAGEMENT: THE BANK'S POLICY APPROACH 1, in
EUROPEAN BANK FOR RECONSTRUCTION AND DEVELOPMENT, ENVIRON-
MENTAL PROCEDURES annex 1 (1992) [hereinafter ENVIRONMENTAL
MANAGEMENT].
41 See SHIHATA, A COMPARATIVE ANALYSIS, supra note 36, at 48.
Shihata describes the Bank's environmental provisions as containing
"modern language" which is interpreted to mean that the provision
reflects what is now considered good policy for multilateral development
institutions. See id. at 48-49.
42 See EUROPEAN BANK FOR RECONSTRUCTION AND DEVELOPMENT,
ENVIRONMENTAL PROCEDURES 1-5 (1992) [hereinafter ENVIRONMENTAL
PROCEDURES]; infra sections 2.1.1.1. to 2.1.1.3.
43 See infra section 2.1.2.
44 See ENVIRONMENTAL MANAGEMENT, supra note 40, at 1-2; infra
section 2.1.1.4.
45 See ENVIRONMENTAL PROCEDURES, supra note 42, at 41-42; infra
section 2.1.1.5.
46 See ENVIRONMENTAL PROCEDURES, supra note 42, at 42.
assume environmental liabilities associated with both the entity and the property of the entity.\textsuperscript{47}

2.1.1. Environmental Conditionality and Traditional Risk Mitigation

2.1.1.1. Environmental Due Diligence

The Bank imposes environmental conditionality by requiring adherence to an elaborate environmental due diligence process during the evaluation stages of projects, prior to financing approval by the Bank, and also during loan negotiation.\textsuperscript{48} During this due diligence process, the Bank, like any other financing entity, will determine whether it will undertake the project, and if so, what types of provisions concerning environmental protection and management should be incorporated into the loan agreement or share participation. The Bank's Environmental Procedures, including screening, environmental review, and supervision, must be followed for all projects in which the Bank participates.\textsuperscript{49} The purpose of the Environmental Procedures is to "guide Bank staff on how to exercise environmental due diligence to ensure that each project is environmentally sound, just as due diligence is performed to ensure that projects are financially, economically and legally sound."\textsuperscript{50} For many years, development banks, as well as commercial banks, have performed due diligence on financial, economic, and legal grounds. A bank could refuse financing of a project if it failed to meet bank standards in these areas. Today, banks additionally assess environmental issues in their due diligence processes.\textsuperscript{51} Such as-

\textsuperscript{47} See EUROPEAN BANK FOR RECONSTRUCTION AND DEVELOPMENT, ROLES OF THE EUROPEAN BANK AND POTENTIAL ENVIRONMENTAL IMPLICATIONS 1, in EUROPEAN BANK FOR RECONSTRUCTION AND DEVELOPMENT, ENVIRONMENTAL PROCEDURES annex 3 (1992). For a background discussion on the Bank's equity financing process, see Linarelli, supra note 10, at 392-93.

\textsuperscript{48} See ENVIRONMENTAL PROCEDURES, supra note 42, at 1-11.

\textsuperscript{49} See id.

\textsuperscript{50} Id. at iii.

assessment is a clear form of conditionality, as a bank will finance only those projects found acceptable to the bank on environmental grounds. The EBRD has made it clear that it maintains the unfettered right to refuse the financing of a project on environmental grounds.

In the Bank’s process of environmental due diligence, a critical juncture is environmental screening, when the Bank’s environmental staff determines the need for an “environmental assessment” and an “environmental audit” from the project sponsor. An environmental assessment is an “intensive examination of the environmental impacts of projects which are likely to have diverse and significant environmental impacts.” An environmental audit is “an environmental study conducted to determine environmental concerns and potential liabilities associated with a property transfer or ongoing operations.”

The Bank divides environmental assessment into three categories. Category A is the most extensive assessment, and is reserved for projects involving “[d]iverse and significant potential environmental impact.” Projects falling within Category A include the development of petrochemical plants, oil and gas development projects and pipelines, dam and reservoir projects, and large-scale industrial projects. Category B includes projects with “[s]ignificant potential impact which can be readily identified and quantified and for which remedial measures can be prescribed without much difficulty.” Projects falling within Category B normally require less stringent environmental analysis and include electrical transmission projects, projects for the development of general manufacturing, and telecommunications projects. Category C is reserved for projects with “[i]nsignificant potential impact” which do not require environmental assessment, such as family planning.

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52 See id.
53 See ENVIRONMENTAL PROCEDURES, supra note 42, at 7.
54 Id. at 51.
55 Id.
56 ENVIRONMENTAL MANAGEMENT, supra note 40, at 11.
57 See id.
58 Id. at 12.
59 See id.
nutrition, and technical assistance projects. The Bank requires an environmental audit of projects involving property transfer, property lease, or modification of an existing operation. The purpose of an audit is to "identify any environmental concerns which may be a potential liability, either to the sponsor or to the Bank." Environmental audits are thus similar to due diligence investigations conducted by commercial banks, foreign investors, and parties to a merger or acquisition.

2.1.1.2. Loan Covenants

In furtherance of the Bank’s environmental mandate, EBRD loans may contain specific covenants concerning environmental issues. The Bank’s Environmental Procedures provide that “[e]nvironmental requirements of transactions which are identified as necessary during project preparation and environmental review will be incorporated into loan agreements as covenants.” A financing agreement cannot be finalized until appropriate clauses concerning the environment are included in the agreement. Similar to all development banks, the EBRD uses “Standard Terms and Conditions” in its public sector loan agreements. Specific loan covenants may work in conjunction with the Standard Terms and Conditions to provide effective provisions governing environmental matters.

With regard to loan covenants, the EBRD’s environmental conditionality can best be described through an example. In the latter half of 1994, the Bank approved a loan and equity investment in SLOVALCO, a company in which ZSNP, the Slovak national aluminum company, owned an

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60 Id.
61 See id. at 6.
62 ENVIRONMENTAL PROCEDURES, supra note 42, at 34.
63 Id. at 5.
64 See id. at 21.
65 See EUROPEAN BANK FOR RECONSTRUCTION AND DEVELOPMENT, STANDARD TERMS AND CONDITIONS (Sept. 1994), reprinted in Memorandum from Vicki Hitchcock to John Linarelli (Apr. 24, 1995) (on file with author) [hereinafter EBRD STANDARD TERMS AND CONDITIONS].
80% share. SLOVALCO was created to finance the completion of a modern aluminum smelter to replace two polluting and inefficient smelters. The Bank's financing was to assist ZNSP in its privatization and restructuring of the aluminum operation. An environmental audit and Category A environmental assessment were conducted prior to approval of the financing by the EBRD, which resulted in an "Environmental Action Agreement" between the Bank and ZSNP as a condition of Bank financing. Because two of ZSNP's smelters did not meet contemporary environmental standards, the Action Agreement required the immediate closure of one of the smelters and the closure of the second smelter no later than three months after the start-up of a portion of the new facility. Moreover, under the current financing agreements, the EBRD will allow continued production only if the plants are operated in accordance with applicable environmental standards, which will require additional improvements by ZSNP. Yet another condition of the EBRD's investment, which was set forth in an Environmental Remediation Agreement, was that ZSNP take immediate steps to contain pollution at its plant. The Bank has thus incorporated extensive covenants related to environmental issues in the financing documentation for this private sector project.

In the public sector realm, the EBRD's Standard Terms and Conditions contain an extensive set of provisions relating to environmental protection and management. The Standard Terms and Conditions provide as follows:

The Borrower shall carry out the Project or cause the Project to be carried out with due diligence and efficiency in accordance with sound environmental

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67 See id.
68 See id.
69 See id.
70 See id.
71 See id.
72 See id.
and other relevant standards and practices and shall provide, promptly as needed, the funds, land, facilities, services, and other resources required for these purposes.\(^73\)

The "due diligence and efficiency" aspects of this provision appear to reflect the duty to cooperate in good faith found in both the common law and civil codes. The presence of a good faith duty in a public sector loan agreement is particularly prudent because an EBRD loan agreement may be classified as a treaty governed by public international law, which may be unclear as to the obligations of the parties to a loan agreement, especially when compared to established domestic law.\(^74\) The domestic environmental laws of the developing countries in question may also be uncertain and undeveloped. Thus, the Standard Terms and Conditions seem to set forth a general duty to act responsibly towards the environment even in the face of international and domestic legal uncertainty. Since the above provision does not define the term "environmental and other relevant standards and practices," these standards and practices should be defined in the specific terms of the loan agreement.\(^75\)

Other pertinent provisions, dealing with suspension, cancellation, and acceleration of maturity, exist in Article VII of the Bank's Standard Terms and Conditions for development bank lending.\(^76\) Although Article VII does not appear to deal expressly with environmental issues,
when coupled with specific covenants in a loan agreement, its provisions could be quite powerful. These Article VII provisions allow the Bank to suspend — and eventually cancel — the borrower’s right to drawdowns and to accelerate the maturity of the loan, if the borrower fails to comply with the obligations of the loan agreement.\textsuperscript{77} The suspension and cancellation provisions, moreover, are cross-conditional in nature. That is, if the Bank suspends drawdowns under one loan, it may then also suspend drawdowns under any other loan to the borrower.\textsuperscript{78} Thus, one breach of an environmental covenant could result in the cancellation of all EBRD loans to a given borrower.

2.1.1.3. \textit{Supervision and Monitoring}

A third manner in which the Bank implements its environmental mandate is by supervising and monitoring compliance with the environmental aspects of a project during implementation. As explained by the Bank:

\begin{quote}
Environmental supervision is undertaken while a loan is being supervised by the Bank. It ensures that the Project Sponsor carries out the environmental measures specified in the Agreement and takes appropriate actions in cases of non-compliance. Supervision will include checking both on the monitoring carried out by the Project Sponsor and reviewing the progress of environmental mitigation or enhancement measures specified as part of the project design.\textsuperscript{79}
\end{quote}

Although the borrower is usually required to perform this

\textsuperscript{77} See id. § 7.01(a)(v); see also Head, supra note 51, at 17 (discussing forms and enforcement of environmental conditionality in the operations of international development finance institutions).

\textsuperscript{78} See \textit{EBRD STANDARD TERMS AND CONDITIONS}, supra note 65, § 7.01(a)(v).

\textsuperscript{79} See \textit{ENVIRONMENTAL PROCEDURES}, supra note 42, at 5.
monitoring function, and to furnish reports to the Bank,\textsuperscript{80} the Bank may perform its own monitoring with its staff or through third parties.\textsuperscript{81} In the event that the borrower misrepresents the environmental conditions to the Bank, the Bank has a variety of measures at its disposal, including, as explained above, suspension and cancellation of loan drawdowns and acceleration of loan maturity, as well as notification of the appropriate authorities, financial agencies, and co-financers, who may also take action.\textsuperscript{82}

At the time of project completion, the Bank will evaluate environmental issues, and may require environmental monitoring to continue well after project completion.\textsuperscript{83} These post-project monitoring requirements would typically be included in the project loan agreement if the Bank deems them necessary.\textsuperscript{84} The supervision and monitoring provisions allow the Bank to perform comprehensive environmental oversight of its projects in accordance with the express environmental mandate contained in its Articles of Agreement.

\textbf{2.1.1.4. Public Participation in Environmental Decisionmaking}

The Bank's express statement of policy on the issue of public participation in environmental decisionmaking is as follows:

Local participation in the economic transformation process will be essential for the success of the decentralization and democratization process in the countries of operations. The Bank will ensure that Project Sponsors provide adequate information on the environmental impacts of projects to governments at all levels and to the general public, especially poten-

\begin{itemize}
\item \textsuperscript{80} See \textit{id.} at 48; EBRD STANDARD TERMS AND CONDITIONS, \textit{supra} note 65, § 4.01.
\item \textsuperscript{81} See \textit{ENVIRONMENTAL PROCEDURES, supra} note 42, at 48 (citing Environmental Staff Guidelines).
\item \textsuperscript{82} See \textit{id.} at 49.
\item \textsuperscript{83} See \textit{id.}.
\item \textsuperscript{84} See \textit{id.} at 5.
\end{itemize}

https://scholarship.law.upenn.edu/jil/vol16/iss3/1
tially affected parties, and that the comments and opinions expressed by these parties will be taken into account in the project approval procedures of the Bank. 85

To accomplish its task, the Bank has prepared a document entitled “Guidance and Procedures for Ensuring Public Participation.” 86 This document mandates procedures in addition to those already required by the government of the country or locality in which the project is situated. 87 The Bank, moreover, may require loan covenants specifying what the Bank considers to be adequate public participation procedures as a condition of loan approval. 88

2.1.1.5. Leveraging Through Intermediaries

Finally, the Bank has imposed its environmental mandate on intermediaries. An intermediary is an institution in which the Bank invests, either in the form of debt or equity, which in turn lends to borrowers. 89 These intermediaries often are ventures between Western and newly privatized banks in Central or Eastern Europe. 90 Through such intermediaries, the Bank can make indirect investments in projects that are otherwise too small for the Bank to finance directly. 91

The Bank’s Environmental Management Policy provides as follows with respect to intermediaries:

When the Bank channels its assistance through a corporate or financial intermediary, standards and procedures will need to be applied for each major

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85 ENVIRONMENTAL MANAGEMENT, supra note 40, at 9.
86 EUROPEAN BANK FOR RECONSTRUCTION AND DEVELOPMENT, GUIDANCE AND PROCEDURES FOR ENSURING PUBLIC PARTICIPATION, reprinted in EUROPEAN BANK FOR RECONSTRUCTION AND DEVELOPMENT, ENVIRONMENTAL PROCEDURES, supra note 42, at annex 4 [hereinafter GUIDANCE AND PROCEDURES].
87 See id. at 1.
88 See ENVIRONMENTAL MANAGEMENT, supra note 40, at 9.
89 See ENVIRONMENTAL PROCEDURES, supra note 42, at 51.
90 See id. at 41.
91 See id.
sub-project. For this reason, the Bank will assess the overall environmental performance and capabilities of the sponsoring organization to carry out the environmental review of projects. . . . The Bank will require that environmental quality levels similar to its own be applied in cases of associated lending.92

This policy is similar to flowdown requirements that are used in government procurements to promote environmental and social policies through the procurement process.93 Intermediaries are required to report annually to the Bank on environmental issues that are relevant to their portfolio.94 The Bank has agreements with at least fifteen banks in twelve countries that flow down the Bank's environmental mandate.95

2.1.2. Environmental Projects and Programs

In addition to the above environmental policies and procedures governing the Bank’s projects generally, the Bank has engaged in financing and technical assistance projects relating directly to environmental matters. The Bank, for example, is significantly involved in financing projects for environmental infrastructure—particularly for the environmental clean up and environmental management of the Baltic Sea and the Danube River Basin.96 One such project, co-financed by grants from Finland and the EU’s PHARE program, is for the improvement of the facilities of the Tallinn Water and Sewerage Municipal Enterprise, located on the Estonian shores of the Baltic Sea and the Gulf of Finland.97 Ad-

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92 See ENVIRONMENTAL MANAGEMENT, supra note 40, at 8.
93 See CIBINIC & NASH, supra note 37, at 942-43.
94 See ENVIRONMENTS IN TRANSITION, supra note 66, at 20.
95 See id.
96 See id. at 7-11.
97 See id. at 7-8. PHARE is an acronym for Poland/Hungary: Assistance for Restructuring of the Economy. Today the program covers assistance to all Central and Eastern European Countries. See Gerwin van Gerven & Takao Suami, New Legal Framework for Trade Relations Between the European Community and the Central and Eastern European Countries, 19 INT'L BUS. LAW. 149, 157 n.21 (1991). Within the EC Commission a special task force has been set up which is
ditional environmental initiatives include the financing of projects to increase efficiency in energy transformation and transport.\textsuperscript{98} Furthermore, the Bank has set several environmental policy priorities for Central and Eastern Europe and will assist countries in: (1) the formulation of environmental policy; (2) the development of laws and regulations concerning the environment; (3) the adoption of appropriate emissions and effluents standards; and (4) the development of the appropriate institutional and managerial capacity to enforce such legal and policy instruments.\textsuperscript{99} A "key priority" for the Bank "is to assist the countries of operations in adopting environmental policy instruments to govern effectively the behavior of economic agents."\textsuperscript{100} As for the base for the Bank’s environmental policies, the Bank relies on the principles of the EU.\textsuperscript{101} In the Bank’s view, relying on EU standards will promote the harmonization of environmental principles.\textsuperscript{102} The Bank will consider more stringent standards for geographical areas that have particularly sensitive environmental problems.\textsuperscript{103} The Bank has recommended environmental policy reform, reasoning that "most of the environmental problems may be traced to inappropriate and distortionary economic policies in the countries of operations."\textsuperscript{104} A requirement for successful environmental programs "is the linkage with a framework of structural changes which are initiated and implemented by the countries themselves."\textsuperscript{105}

### 2.1.3. Some Legal and Policy Implications

In the environmental area, the Bank has taken on self-interested, protective functions as well as proactive policy functions. These two functions are not mutually

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\textsuperscript{98} See id. at 12-13.

\textsuperscript{99} See ENVIRONMENTAL MANAGEMENT, supra note 40, at 1-2.

\textsuperscript{100} Id. at 3.

\textsuperscript{101} See id. at 2.

\textsuperscript{102} See id.

\textsuperscript{103} See id.

\textsuperscript{104} Id. at 1.

\textsuperscript{105} Id.
exclusive. For example, the Bank’s environmental due diligence may serve both to mitigate the Bank’s exposure to environmental liability and to promote projects that do not pollute the environment. The protective functions are the traditional functions that any investor would perform in order to protect itself. The Bank, however, has gone much further than merely protecting itself by actively pursuing specific environmental programs and imposing environmental conditions in its financing documentation. In actuality, the Bank is doing much more in the environmental sphere than in the political sphere.  

Legal scholars appear to address the environmental issues relating to the Bank more than any other subject. The literature is either critical or recommends various methods of implementation of the Bank’s environmental mandate. The recommendations center on the idea of creating bureaucratic review structures in or by the Bank. The creation of such a bureaucratic review structure may be difficult as the borrowing countries are in transition and are struggling to establish democracies. One sign or function of a working democracy is participatory pluralism — the effective involvement of people and

106 See infra section 2.2.1.
109 See Franck, The Emerging Right to Democratic Governance, supra note 10, at 46. As explained by Professor Zaphiriou in the context of the United States:

As a result of participatory pluralism in the United States, American law reform is achieved by the balancing of opposed interests in the light of proximate, reliable and readily accessible experimentation within diverse, though basically compatible, social environments. The American legal establishment, under the influence of a strong tradition of sociological jurisprudence represented by Holmes, Pound, Frank, the radical
groups in political decisionmaking, and not merely at the voting polls. Institutions designed to involve public participation should be promoted at the country or community level as well as at the Bank level.

Established and effective administrative procedures necessary for public participation, as well as substantive environmental standards, are not practical at the national or subcentral level in the Bank's countries of operation without the precondition of sufficient legal infrastructure in these countries. The necessary legal infrastructure, however, is probably inadequate in many of these countries at this time. Furthermore, one must be wary of any attempted transplantation of laws and bureaucratic structures from one country to another that do not account for country-specific idiosyncrasies in a rigorous, comparative fashion. Approaches that too closely resemble the U.S.

Llewellyn of the 30s, and the establishment Llewellyn of the 60s, is well aware that "[t]he first requirement of a sound body of law is that it should correspond with the actual feelings and demands of the community."


See Present at the Creation, supra note 107, at 86 (arguing that the EBRD should lend to projects promoting development of market infrastructure).

See Hon. Roberto MacLean U., Court and Statute Law in Peru, 28 AM. J. COMP. L. 487, 490 (Dale Beck Furnish trans., 1980). The borrowing countries of the Bank avoid what has happened in two countries 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
National Environmental Policy Act and other U.S. laws dealing with environmental assessment may not be readily transplanted to the countries in question 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, for it may be worse to have a law that is not obeyed than to have no law at all.

This is not to say that substantive environmental standards should not be harmonized. It is axiomatic that nature and its degradation by humankind know no political boundaries. The Bank has taken steps in the right direction by looking to the EU, rather than to the United States, for environmental standards, since the countries of operation share geographical proximity to the EU and many desire EU membership. The procedures by which substantive environmental standards are enforced, however, may vary in countries to a greater extent than the substantive environmental standards themselves.

The EBRD’s borrowing countries should be alert to any undue allocation of responsibilities placed upon them to finance the massive investments needed for environmental remediation and protection. Admittedly, the former governments of these countries caused significant environmental damage. Nevertheless, aid programs should approach the problem of environmental remediation as a European problem and not merely as national problems of single countries. Since the environmental damage involves externalities, the Western Europeans will benefit greatly from cleanup in Central and Eastern Europe.113

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Id. at 490.


113 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 externalities issue is related to what has been called the "symmetry of adjustment" debate concerning conditionality in structural adjustment loans made by the IMF.\textsuperscript{114} The Fund makes short-term loans to countries to alleviate balance of payments problems.\textsuperscript{115} These loans are based on conditionality — the Fund makes only a portion of a loan immediately available and makes the remaining portions available as long as the country meets certain conditions, usually stringent monetary and fiscal conditions.\textsuperscript{116} Some scholars have argued that a developing country should not be required to bear all of the costs of this conditionality when its balance of payments deficit is beyond the control of the borrowing government.\textsuperscript{117} The argument is that there is a country or set of countries with a balance of payments surplus corresponding to the balance of payments deficit extending.

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 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 107, at 87.

\textsuperscript{114} Head, *supra* note 51, at 21-23.

\textsuperscript{115} See id. at 21.

\textsuperscript{116} See id.

\textsuperscript{117} See id. at 22.
perceived by the developing country, and, in appropriate circumstances, the countries with the surpluses should also bear some responsibility for alleviating the deficit. 118

Similarly, the argument can be made that several countries should share the burden of "environmental adjustment." 119 Unlike the other multilateral financial institutions that are restrained from pursuing such adjustment, 120 the EBRD has an express mandate that could allow it to pursue symmetry in environmental adjustment in certain circumstances. Also, the Bank is not significantly limited by principles of sovereignty because of its express political mandate. 121 The Bank is, however, somewhat constrained by its Articles of Agreement because at least sixty percent of the Bank's investments must be on the merchant banking side of the Bank. The Bank can devote no more than forty percent of its financing to concessional public sector lending, which includes investment for environmental programs. 122 This constraint is magnified by the Bank's relatively low capitalization in comparison to the World Bank and the Bank's aggressive market maximization approach to investment. 123 Given the constraints of its Articles of Agreement and its own self-imposed constraints, the Bank may not have the flexibility to provide the concessional financing that would promote symmetry of adjustment. The Bank has relied on grant financing from PHARE and from member governments to deal with this problem. 124

Additional restrictions on the Bank stem from what has been called "the tyranny of the discount rate." 125 This tyranny works both ways. The Bank's environmental

118 See id.
119 See id.
120 See id. at 24.
121 See infra section 2.2.2.2.
122 See supra text accompanying note 31; infra text accompanying notes 159, 202-03, 275, and 279.
123 See supra note 26 and accompanying text.
124 See ENVIRONMENTS IN TRANSITION, supra note 66, at 7-8 (explaining that the Bank has relied on grants from both Finland and PHARE for the Tallinn water and environment project).
mandate can be interpreted as a restriction on investment, particularly private investment. A project, such as a large-scale oil and gas development project, may be highly desirable from an economic development perspective, but may not pass muster under the Bank's stringent environmental review process. The environmental obstacles associated with a project may cause the project to be uneconomical, particularly if one applies market-based interest rates to the project.

The Bank's task is made more difficult if one compares the goals of sustainable development and inter-generational equity, fostered by the Bank's environmental program, with the need for relative equities among Bank members. The idea of intercountry equity is closely related to the idea of intergenerational equity, since each generation exists and comes into being within the boundaries of countries in the present international order. The countries in need of large-scale projects, which implicate difficult Category A environmental assessments, may not receive their fair proportion of projects, even though these countries may be the least developed. These countries may view a modicum of environmental problems as an acceptable price for increased socio-economic welfare. The closest that the Bank's Articles of Agreement come to dealing with this issue of intercountry equity is in Article 13, paragraph iv, which says that "the Bank shall not allow a disproportionate amount of its resources to be used for the benefit of any member." The apparent intent of this provision was to prevent the Soviet Union, in the waning days of its existence at the time of the Bank's formation, from swallowing up the lion's share of the Bank's financing. This

126 This analysis was suggested by Professor Peter Fox.
127 “Sustainable development” has been defined as “development that meets the needs of the present without compromising the ability of future generations to meet their own needs.” IBRAHIM F.I. SHIHATA, THE WORLD BANK IN A CHANGING WORLD: SELECTED ESSAYS 136-37 (Franziska Tschofen & Antonio R. Parra eds., 1991) [hereinafter SHIHATA, SELECTED ESSAYS] (quoting BRUNDTLAND COMMISSION, WORLD COMMISSION ON ENVIRONMENT AND DEVELOPMENT, OUR COMMON FUTURE (1987)).
128 This point was suggested by Professor Peter Fox.
129 Agreement, supra note 13, art. 13(iv), 29 I.L.M. at 1089.
operating principle, however, is limited because it falls short of providing for intercountry equity.

Environmental protection and management can be viewed from a rights paradigm. A right to development has been articulated, but not without controversy. The "right" to a clean environment is bound together with other economic and social rights, such as the rights to basic nutrition, education, health care, and housing. In the taxonomy of human rights, there is a well-established distinction between economic and social rights and civil and political rights. The Bank interprets its political mandate as encompassing primarily civil and political rights. The Bank's environmental mandate, however, is in the category of economic and social rights. The World Bank, in part, justifies its involvement in environmental matters by broadly interpreting its mission as essentially the promotion of economic and social rights. In this sense, the EBRD is really no different than the World Bank or any other multilateral development institution. In fact, given the Bank's conclusion that many environmental problems are caused by structural economic problems, the Bank has essentially admitted that it may have less power than the World Bank, since the EBRD, unlike the World Bank, cannot make policy-based loans.

2.2. Post-Cold War Orthodoxy in the EBRD's Articles of Agreement

The Preamble of the EBRD's Articles of Agreement sets forth important underpinnings for the Bank's existence, including a commitment by the contracting parties to the "fundamental principles of multiparty democracy, the rule

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131 See SHIHATA, SELECTED ESSAYS, supra note 127, at 97-134.
133 See infra notes 151-57 and accompanying text.
134 See SHIHATA, SELECTED ESSAYS, supra note 127, at 97-134.
135 See supra notes 104-05 and accompanying text.
136 See infra section 3.2.2.
of law, respect for human rights and market economics.” In addition, Article 1 of the Bank’s Articles of Agreement sets forth 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.

Furthermore, 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.” Finally, Paragraph 2 of Article 8 provides that:

The Bank may conduct its operations in countries from Central and Eastern Europe which are proceeding steadily in the transition towards


138 Agreement, supra note 13, art. 1, 29 I.L.M. at 1084.

139 Id. art. 8(1) at 1086.
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. 140

The Board of Directors of the Bank is to review, at least annually,141 the Bank's operations "to ensure that the purpose of the Bank, including by implication the political aspects of its mandate, is fully served."142

2.2.1. The EBRD's Implementation of its Political Mandate: Conditionality or Traditional Risk Mitigation?

In analyzing the Bank's political mandate, it is instructive to examine the conditionality that other institutions impose in the context of policy-based loans. Although the EBRD lacks the authority to make such policy-based loans,143 the terms of these loans are nevertheless instructive because it is in policy-based loans that one is likely to find "policy conditions."

An international financial institution would impose conditionality on policy-based loans for essentially two reasons: first, to create a substitute for collateral, and second, to induce behavior that is perceived as beneficial by the lending institution.144 The first reason would also support the existence of conditions in project-based loans. An example of the first type of conditionality is that imposed by the IMF in its stand-by agreements.145 The

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140 Id. art. 8(2).
141 "The Board of Directors shall review at least annually the Bank's operations and lending strategy in each recipient country to ensure that the purpose and the functions of the Bank, as set out in Articles 1 and 2 of this Agreement, are fully served." Id. at 11(2)(i) at 1088.
142 EUROPEAN BANK FOR RECONSTRUCTION AND DEVELOPMENT, POLITICAL ASPECTS OF THE MANDATE OF THE EUROPEAN BANK FOR RECONSTRUCTION AND DEVELOPMENT 2 (citation omitted) [hereinafter POLITICAL ASPECTS]. For a detailed analysis of the forces behind the creation of the Bank's political mandate, see Linarelli, supra note 10, at 375-76.
143 See infra section 3.2.2.
144 See Mosely et al., supra note 15, at 117-19.
145 See id. at 118.
Fund's loans are often designed to alleviate balance of payments difficulties.\textsuperscript{146} The conditions are designed to increase the likelihood of loan repayment and to provide assurances to the Fund that the loan will be repaid.\textsuperscript{147}

An example of the second type of conditionality, where the lender attempts to induce beneficial behavior, is that imposed by the World Bank in its policy-based loans.\textsuperscript{148} World Bank conditionality for these types of loans is not intended to maximize probability of loan repayment, but "to enable the borrower to remove what the lender sees as fundamental policy-induced obstacles to economic growth."\textsuperscript{149}

Notably, neither the World Bank nor the IMF can take political considerations into account in their financing operations, except in the examination of the political risk for a given loan.\textsuperscript{150} In this sense, political considerations, to the extent that they do not involve governance issues, can, at best, form a basis for the assumptions underlying loans, and only may be considered when domestic political circumstances place unacceptable risks on loan or project

\textsuperscript{146} See id. at 117.
\textsuperscript{147} As explained in one authoritative text:
[If there exist government policies which can reliably be expected to increase the likelihood of repayment of the loan, the lender may insist on the implementation of these policies, and suspend disbursement of the loan if the policies are not implemented. This is of course precisely the threat strategy employed by the IMF, which . . . as a general rule requires borrowing governments to implement a package of macroeconomic policy conditions which it believes will improve the balance of payments. These "policy conditions" vary from country to country . . . . The effectiveness of these conditions, and their political and social consequences, remain of course the subject of strenuous controversy, but in the midst of all this, [some] things remain clear and undisputed: the purpose of IMF conditions is to serve as a substitute for collateral, by increasing the likelihood of loan repayment and giving the lender an early warning of potential repayment difficulties; the conditions are defined in terms of unambiguous, and monitorable, performance indicators . . . .]

\textsuperscript{148} See id. at 118.
\textsuperscript{149} Id.
\textsuperscript{150} See infra text accompanying notes 168-70; see also Head supra note 9, at 637-38.
Although its express political mandate affords it greater opportunities to act, the EBRD appears to be doing even less than the World Bank and the IMF with respect to political considerations. Despite its express political mandate, the Bank made a decision early on to assess the political progress of the borrowing countries on an annual basis, rather than on a project-by-project basis. The Bank has de-emphasized political issues in its activities. The Bank essentially engages in surveillance functions designed to ensure that it provides financial assistance only to those countries that comply with the Bank’s political criteria. The Bank’s political conditionality is thus not true “conditionality,” in the sense that a borrower must fulfill certain conditions in order to be eligible for tranches or drawdowns, or in the sense that the lender seeks to provide incentives during loan administration. The Bank’s political mandate is implemented more in the nature of underlying assumptions concerning a country’s political status. Political conditionality is more a restraint on the Bank generally than a condition on the Bank’s financing. This political conditionality is in contrast to the Bank’s implementation of environmental conditionality. With respect to environmental issues, the Bank has imposed conditions more in the nature of the second type of conditionality, to induce behavior that the

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151 No other international financial institution has such a political mandate, and the significance of this mandate is “difficult to exaggerate.” See Head, supra note 9, at 638.

152 See POLITICAL ASPECTS, supra note 142, at 4.


154 See POLITICAL ASPECTS, supra note 142, at 4.

155 Tranches are parts of a loan identified by a particular loan currency or interest rate, as provided for in the loan agreement. See EBRD STANDARD TERMS AND CONDITIONS, supra note 65, at 6.

156 Professor Peter Fox has suggested that the IMF makes political considerations part of the assumptions underlying stand-by arrangements. See also Mosely et al., supra note 15, at 119 (stating that the World Bank uses conditionality in attempts to influence economic policy).
EBRD perceives as beneficial.\textsuperscript{157}

Several institutional constraints, including a clear "clash of mandates"\textsuperscript{158} in the Bank's Articles of Agreement, preclude the Bank from doing more politically than it does already. The Bank has a private sector focus and it is required to place sixty percent of its financing into the private sectors of its countries of operations.\textsuperscript{159} Additionally, the Bank possesses both development bank and merchant bank functions.\textsuperscript{160} It would be a serious contradiction, as well as impose conditions on a private sector borrower over which it would have no control, to provide private sector loan or equity financing while imposing requirements, derived from political considerations, which affect the availability of the funds.\textsuperscript{161} It would be extremely awkward and onerous for the Bank to terminate private sector financing on the basis of political considerations extraneous to the loan. Another constraint on the Bank in implementing its political mandate is that the Bank's Articles of Agreement specifically prohibit policy-based lending,\textsuperscript{162} which would be a primary vehicle for implementing political conditions.\textsuperscript{163}

One of the EBRD's effective tools, however, is its ability to impose political conditionality through suspension of its operations in a country. 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

\textsuperscript{157} See supra section 2.1.1.
\textsuperscript{158} Professor Peter Fox has suggested this "clash of mandates" language.
\textsuperscript{159} See supra text accompanying notes 31, 122; infra text accompanying notes 202-03, 275, and 279.
\textsuperscript{160} See infra note 201 and accompanying text.
\textsuperscript{161} Professor Peter Fox has suggested this contradiction.
\textsuperscript{162} See infra section 3.2.2.
\textsuperscript{163} See SHIHATA, SELECTED ESSAYS, supra note 127, at 70-71.
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.\footnote{Agreement, supra note 13, art. 8(3), 29 I.L.M. at 1086.}

The measures that the Bank may take include postponement of proposed operations, restrictions on operations, and suspension of operations.\footnote{See POLITICAL ASPECTS, supra note 142, at 5.}

As a counterbalance to its suspension powers, the Bank appears concerned about unduly restricting private sector or community incentives when faced with an oppressive national government. For example, the Bank's guidelines consider “curtailing planned public sector projects before taking action on private operations” and “[w]ithin the public sector, curtail[ing] state infrastructure projects before local ones and endeavour[ing] to continue with its technical cooperation activities as long as possible.”\footnote{Id.}

As for decisions based on political criteria that would be inconsistent with sound banking practice, the Bank, as a matter of prudence, “will need to consider carefully its own financial position as well as the legitimate financial interests of relevant third parties”\footnote{Id.} in any analysis of the issues. The Bank must be careful not to place itself in vulnerable positions, where it could be exploited by the unscrupulous in countries with fledgling democracies. The Bank thus appears to “condition its political conditionality” on financial considerations. In a hierarchy of considerations examined by the Bank in its operations, the Bank has apparently relegated its political mandate to the back seat.

The essential difference between a Bretton Woods institution, such as the World Bank, and a post-Cold War institution, such as the EBRD, is that each lacks a different type of discretion in the political realm. Because of its Articles of Agreement, the EBRD must take political
considerations into account and limit its operations to countries that meet certain political criteria. Of course, the Bank does maintain some discretion in the identification of the political criteria, and even more discretion in the application of those criteria.

On the other hand, because of its Articles of Agreement, the World Bank cannot take political considerations into account in its lending activities. Thus, in the 1960s, the World Bank made loans to South Africa and Portugal despite resolutions by the United Nations General Assembly demanding that the World Bank not provide financial assistance to these countries because of their poor records on human rights. The position of the World Bank at the time was that its Articles of Agreement forbade it to refuse financing for political reasons. In the same situation, however, the EBRD would be forbidden by its Articles of Agreement to provide financial assistance. Despite this political restriction, the World Bank has interpreted its Articles of Agreement to provide it with the discretion to consider political risk and governance issues and their effects on the prudence of the Bank's lending activities and in the Bank's international obligations.

The EBRD's political mandate gives the EBRD the easy ability to impose "policy conditions" upon individual projects, essentially at its election and as the circumstances dictate, without the need for an analysis of whether the Bank has gone too far in its concern over a delimiting concept such as "good governance." Such "policy conditions" may reflect "hybrid" considerations that deal, to some extent, with politics, but will most likely concern matters of sectoral policy, such as issues of taxation, enterprise restructuring, and competition policy.

A pragmatic view requires the acknowledgment that decisions concerning political issues are made by people —

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168 See SHIHATA, SELECTED ESSAYS, supra note 127, at 77-79.
169 See id. at 77.
170 See id. at 55-57.
172 See, e.g., id. at 37, 39-40.
both in the Bank as well as in the borrowing countries. People “operationalize” the political conditionality of the Bank. Thus, political conditionality may be subject to varying discretionary attitudes, which could expose the Bank to allegations of abuse of power. The Bank’s implementation of its political mandate through broad reviews of country conditions, rather than through specific conditions in loan operations, may help the Bank to avoid such allegations.

The essence of the Bank’s functions, at least as set forth in its Articles of Agreement, is “nationbuilding,” a controversial task. The Bank’s Articles of Agreement focus on the development of market infrastructure necessary for countries in transition to move toward multiparty democracy and market-oriented economies. The founding members of the Bank have invested the Bank with the authority to assist countries in transition towards the “correct” transition, as they have defined it. The EBRD, however, may not have the financial resources to be a dominant financier of this transition. Despite the political connotations incident to the term “nationbuilding,” the World Bank also engages in it, although the World Bank limits its “nationbuilding” primarily to assisting countries with matters of governance, such as civil service reform and legal reform. Regardless of the development assistance provided by institutions such as the EBRD and the World Bank, it is the borrowing countries themselves that must ultimately create their own democracies.

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173 This analysis was suggested by Mr. Sadah Saabneh in a critique of the Article.
174 See infra notes 280-82 and accompanying text.
175 For an explanation of the criteria that may influence the EBRD’s implementation of its political mandate, see Linarelli, supra note 10, at 377-78. That the founders of the EBRD invested it with a political mandate is not the end of the story. What do the terms in the Articles of Agreement, such as “multiparty democracy,” “pluralism,” “respect for human rights,” and “market economics,” mean? These terms are, in all probability, not capable of comprehensive definition, although it is possible to identify criteria. For a discussion of the criteria of the Bank’s political mandate, see id.
176 See SHIHATA, SELECTED ESSAYS, supra note 127, at 79-93.
2.2.2. Some Legal and Policy Implications

2.2.2.1. Potential Conflicts of Interest

The Bank has proffered significant reforms for its countries of operations. These reforms can be found in the various Bank papers which discuss “issues and options” and operational policies for the different economic sectors of the countries in which the Bank operates.\textsuperscript{177} Potentially, such involvement with reform may create an organizational conflict of interest for the Bank. The Bank may find itself in the position of promoting competition policy in its countries of operation while contemporaneously investing in monopolies.\textsuperscript{178} As explained by the Bank:

\begin{displayquote}
[T]he Bank confronts possibly unique conflicts in its dual role as both a Merchant Bank and a Development Bank. That is because maximizing profits of its private clients can sometimes be inconsistent with maximizing social welfare. The potential conflict is greatest where private clients have already succeeded in obtaining government grants of monopoly positions before approaching the Bank. Such cases raise questions as to who is the Bank’s client — the would-be (or actual) monopolist who approached the Bank, or the government who is the shareholder in the institution? If the Bank approaches the government on the issue, it will be working against the interests of its (potential) private client in breach
\end{displayquote}

\textsuperscript{177} See generally EUROPEAN BANK FOR RECONSTRUCTION AND DEVELOPMENT, AGRICULTURAL OPERATIONS POLICY PAPER (1993); EUROPEAN BANK FOR RECONSTRUCTION AND DEVELOPMENT, ENERGY OPERATIONS POLICY (1992); EUROPEAN BANK FOR RECONSTRUCTION AND DEVELOPMENT, FINANCIAL SECTOR OPERATIONS POLICY (1992)[hereinafter FINANCIAL SECTOR OPERATIONS]; EUROPEAN BANK FOR RECONSTRUCTION AND DEVELOPMENT, MUNICIPAL DEVELOPMENT OPERATIONS POLICY (1992); EUROPEAN BANK FOR RECONSTRUCTION AND DEVELOPMENT, TELECOMMUNICATIONS OPERATIONS POLICY (1992)[hereinafter TELECOMMUNICATIONS POLICY]; EUROPEAN BANK FOR RECONSTRUCTION AND DEVELOPMENT, TRANSPORT OPERATIONS POLICY (1992); TRANSPORT SECTOR, supra note 171.

\textsuperscript{178} This point was suggested by Professor Peter Fox.
of accepted practices.\textsuperscript{179}

To its credit, the Bank recommends the maximization of privatization and competition, views many of the monopolies as temporary, and makes loans to monopolies only in a manner consistent with its policies.\textsuperscript{180} The Bank has offered the following as a potential solution:

It is suggested that the appropriate response in at least most if not all cases should be to inform the private client directly that a conditionality of Bank participation would be that it must relinquish its monopoly position or agree somehow to circumscribe it in time or space to delimit the potential negative impacts on the greater social welfare. It should normally be possible to define such arrangements which would still provide an adequate opportunity for the private investor to recoup his capital plus a potential return commensurate with the risks being borne.\textsuperscript{181}

The Bank thus has determined that some form of project-based conditionality may be appropriate to avoid serious conflicts of interest, even where a government in a country of operation has granted a monopoly in accordance with its laws. Notably, concerns over monopolistic positions and social welfare may be in the realm of governance or economic and social rights, over which the World Bank contends it also has authority. The EBRD has not included antitrust issues in its list of political criteria that it regularly monitors,\textsuperscript{182} although an express function of the Bank is to assist countries "to implement structural and sectoral economic reforms, including demonopolization."\textsuperscript{183}

Not only may the Bank encounter potential conflicts of interest due to its dual role, but incongruities also may

\textsuperscript{179} \textit{TRANSPORT SECTOR}, \textit{supra} note 171, at 40.
\textsuperscript{180} See \textit{TELECOMMUNICATIONS POLICY}, \textit{supra} note 177, at 5-7, 16, 21.
\textsuperscript{181} \textit{TRANSPORT SECTOR}, \textit{supra} note 171, at 40.
\textsuperscript{182} See \textit{POLITICAL ASPECTS}, \textit{supra} note 142, at 4.
\textsuperscript{183} Agreement, \textit{supra} note 13, art. 2(1), 29 I.L.M. at 1084.
exist between the Bank's broad goals and its ability to implement its goals. For example, although an explicit function of the Bank is to assist countries to implement structural and sectoral economic reforms, which includes demonopolization, it cannot finance such reforms. This conflict between broad policy and specific action has the risk of surfacing in economic sectors such as the telecommunications sector.

2.2.2.2. Issues of Sovereignty and Implications for Multilateralism

Some have suggested that unfavorable decisions by the EBRD based on political criteria could expose the EBRD to charges of interference in domestic affairs or infringement of sovereignty. These arguments of interference or intervention fail to withstand serious scrutiny. So long as its actions are consistent with its Articles of Agreement, the Bank has sufficient discretion to take whatever actions it deems appropriate.

As a threshold matter, the borrowing countries are shareholders in the Bank. The Bank lends to members, and these members have consented fully and freely to the Bank's Articles of Agreement. Member nations have given up a piece of their sovereignty in the execution of the Articles of Agreement, which is a treaty. In essence, the Bank is a credit cooperative, providing valuable leverage of the capital of its members. The borrowing countries accept assistance from the Bank and allow their public and private enterprises to accept such assistance, despite the political conditionality of the Bank's activities, and with full awareness of such conditionality. In light of the many

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184 See Agreement, supra note 13, art. 2(1), 29 I.L.M. at 1084; see also SHIHATA, SELECTED ESSAYS, supra note 127, at 57-58.
185 See infra section 3.2.2.
186 See Easton & Rorer, supra note 17, at 535. For examples of difficult questions surrounding the sovereignty issue, see Linarelli, supra note 10, at 378.
187 See Head, supra note 9, at 606-07, 627.
188 Should a member nation reject Bank assistance, the Bank is bound by such a rejection because "the Bank shall not finance any undertaking in the territory of a member if that member objects to such financing." Agreement, supra note 13, art. 13(iii), 29 I.L.M. at 1089.
manifestations of consent, interventionist arguments are unpersuasive.

If the members of the Bank were somehow "coerced" into membership, then a valid intervention or interference argument could arise. There is no convincing argument, however, that any coercion surrounded the execution of the EBRD's Articles of Agreement. The EBRD's Articles of Agreement is a treaty. Article 51 of the Vienna Convention of the Law of Treaties and Article 51 of the Vienna Convention on the Law of Treaties Between States and International Organizations or Between International Organizations, provide that the consent of a State "to be bound by a treaty which has been procured by the coercion" of the State's representative "through acts or threats directed against him shall be without any legal effect." Moreover, Article 52 of both Conventions provides that a treaty procured by the "threat or use of force in violation of ... the Charter of the United Nations," which does not include economic or political pressure, is "void." The states that are members of the Bank, however, would be hard pressed to prove coercion under these stringent standards. Under these principles of international law, a treaty is vitiated only in circumstances involving quite drastic forms of coercion, and not merely on the basis of unequal bargaining power.

189 See ARON BROCHES, SELECTED ESSAYS WORLD BANK, ICSID, AND OTHER SUBJECTS OF PUBLIC AND PRIVATE INTERNATIONAL LAW 22-29 (1994) [hereinafter BROCHES, SELECTED ESSAYS] (discussing the treaty-like quality of the World Bank's Articles of Agreement which, like the EBRD Articles of Agreement, are binding upon all member nations under principles of international law).


191 See BROWNLIE, supra note 190, at 615.

192 Law of Treaties, supra note 190, 8 I.L.M. at 698; Law of Treaties Between States and International Organizations, supra note 190, 25 I.L.M. at 572.
Furthermore, there is no agreement among jurists that could result in the delimitation of any "unequal treaty" principle which would invalidate treaties not based on sovereign equality of the parties. Although some newly independent states favor the inclusion of an "unequal treaty" doctrine in international law, many of the Communist regimes which were the principal proponents of the doctrine are now defunct, and Western jurists oppose the doctrine on the grounds that it is too vague.193 The "unequal treaty" concept does not appear as such in the Vienna Conventions.

Finally, quite apart from legal principles of consent and coercion, why would a state want to disavow the Articles of Agreement? It would plainly not be in its interest to do so.194 Developing countries typically have a strong voice in international development institutions.195 The countries in transition have the powerful incentives of aid from the West, and eventual membership in the EU. These transitional countries are on their way to democratic pluralism and market economics as a matter of choice and not as a result of any compulsion by the West. Relinquishment of a piece of sovereignty is so fundamental to the treaty practice of states so as not to be of serious concern, particularly when weighed against the benefits of EBRD membership.196

3. EBRD POLICIES DIRECTLY RELATING TO LENDING197

The Bank has the authority to provide three types of

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193 See BROWNLE, supra note 190, at 615-16.
194 See Head, supra, note 9, at 657 (stating that withdrawal from a membership in a treaty organization could create problems in securing external financing and may amount to "self-imposed ostracism" for a state).
195 See id.
196 For a presentation of arguments against nonintervention principles in Europe, and a discussion of the changing norm of democratic governance in Europe in the context of the EBRD, see Linarelli, supra note 10, at 378-81.
197 In addition to its loan operation, the EBRD also has the ability to take equity positions in enterprises. This ability is discussed in Linarelli, supra note 10, at 392-94.
financing arrangements: loans to private enterprises,\textsuperscript{198} loans to the public sector,\textsuperscript{199} and equity investments.\textsuperscript{200} Although the Bank combines the functions of an investment or merchant bank and a development bank,\textsuperscript{201} it may commit no more than forty percent of its funds to the state sector.\textsuperscript{202} 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 question.\textsuperscript{203} The Bank's private sector emphasis is intended to promote economic reform in its borrowing countries and safeguards against the potential for ineffectiveness in public sector financing. It is a very difficult task, however, for a multilateral financial institution to unleash entrepreneurial spirit in developing countries.\textsuperscript{204}

Because the Bank's Articles of Agreement contain seemingly inconsistent mandates for the Bank to be commercial as well as political, it is important to examine the direct lending arrangements of the Bank.\textsuperscript{205} This Section explores several issues raised by the notable, unexamined assumptions apparent in both the Bank's Articles of Agreement and actual operations, including: the Bank's ability to operate as a merchant bank in countries where actual merchant banks experience difficulties or even insurmountable barriers to entry; the provisions and policies that the Bank has chosen to implement its strong private sector mandate; the appropriateness of traditional

\textsuperscript{198} See infra section 3.1.
\textsuperscript{199} See infra section 3.2.
\textsuperscript{200} See Linarelli, \textit{supra} note 10, at 392-93 for a discussion of the Bank's equity financing arrangements.
\textsuperscript{202} See Agreement, \textit{supra} note 13, art. 11(3), 29 I.L.M. at 1088; see \textit{supra} text accompanying notes 21, 122, and 159; \textit{infra} notes 275, 279 and accompanying text.
\textsuperscript{203} See Hearing Before the Subcomm. on International Development, \textit{supra} note 31, at 13-14 (statement of David C. Mulford); see also \textit{Present at the Creation, supra} note 107, at 82-83.
\textsuperscript{205} See \textit{infra} section 3.1.
public sector lending; the Bank's assertion that its public sector loans are international obligations; the inability of the Bank to provide policy-based loans; and finally, in light of its private sector loans, the Bank's controversial assertion that it has preferred creditor status. This last issue is important in determining the payment priority given to external debt and preferences over other forms of debt.

3.1. Private Sector Lending

The Bank's Articles of Agreement provide for the following three types of private sector loans: (1) loans to private enterprises without restriction; 206 (2) loans to state enterprises "operating competitively and moving to participation in the market-oriented economy," 207 and (3) loans to a state enterprise "to facilitate its transition to private ownership and control." 208 Article 11 explicitly provides that a state enterprise is not "operating competitively unless it operates autonomously in a competitive market environment and unless it is subject to bankruptcy laws." 209

3.1.1. Important Loan Provisions

Set forth below is an examination of some of the key provisions that typically appear in EBRD's commercial loan agreements, including provisions governing interest rates and margins, loan maturities and repayments, fees and

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206 See Agreement, supra note 13, art. 11(1)(i), 29 I.L.M. at 1087.
207 Id.
208 Id.
209 Agreement, supra note 13, art. 11(1)(v), 29 I.L.M. at 1088.

Article 11(1)(i) of the Agreement states that the Bank may carry out its aims:

by making, or cofinancing together with multilateral institutions, commercial banks or other interested sources, or participating in, loans to private sector enterprises, loans to any state-owned enterprise 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. at 1087.
expenses, recourse, security, and covenants.\textsuperscript{210} Because the EBRD does not make terms and conditions for these loans publicly available,\textsuperscript{211} this analysis is based on the limited information that the Bank has made publicly available.

As a basic principle, the Bank, in its private sector operations, is required to follow established merchant banking methods in order to avoid imprudent loans. The Articles of Agreement provide that “[i]n setting . . . terms and conditions, the Bank shall take fully into account the need to safeguard its income.”\textsuperscript{212} No such provision exists in the charters of other development institutions, although these institutions as a matter of practice comply with this principle of safeguarding income.\textsuperscript{213} According to the Explanatory Notes to the Articles of Agreement, this safeguard provision is intended to “avoid the risk of . . . [the Bank’s] operations being in practice subsidized from the cost-free resources available to the Bank from members’ paid-in subscriptions.”\textsuperscript{214} Moreover, Article 13 of the Bank’s Articles of Agreement provides that the Bank must invest on financial “terms and conditions . . . taking into account . . . the terms and conditions normally obtained by private investors for similar financing . . . .”\textsuperscript{215}

3.1.1.1. Interest Rates and Margins

The Bank does not have the ability to make “soft” loans at concessionary or subsidized rates,\textsuperscript{216} therefore, it typically sets its interest rates at a margin over a market

\begin{footnotesize}
\begin{itemize}
\item[(210)] For a discussion of key bank strategies, as opposed to key loan provisions, such as co-financing and syndication, the use of joint ventures, and the encouragement of mixed equity and debt financing, see Linarelli, supra note 10, at 384-85.
\item[(211)] See Memorandum from Vicki Hitchcock, European Bank for Reconstruction and Development, to John Linarelli (Apr. 24, 1995) (on file with the author) (“Unfortunately documentation on private sector projects is not available.”) [hereinafter Memorandum].
\item[(212)] Agreement, supra note 13, art. 14(1), 29 I.L.M. at 1089.
\item[(213)] See SHIHATA, A COMPARATIVE ANALYSIS, supra note 36, at 63.
\item[(214)] EXPLANATORY NOTES, supra note 34, at 58.
\item[(215)] Agreement, supra note 13, art. 13(xi), 29 I.L.M. at 1089.
\end{itemize}
\end{footnotesize}
benchmark rate. The benchmark rate is normally the London Interbank Offered Rate ("LIBOR rate"). The loan agreement will set forth a formula for determining the EBRD interest rate, usually by adding a margin to the LIBOR rate. Although swing-line options are a common alternative, the Bank apparently has not indicated an interest in providing them.

The LIBOR rate would reflect the Bank's capital costs, while the margin would account for risk and provide the Bank with a profit. The added margin 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." Moreover, the Bank has a AAA credit rating. Given the Bank's touted status as a preferred creditor and its AAA credit rating, the EBRD may be able to borrow funds at lower rates than those typically provided to commercial banks. Thus, the Bank could either earn a greater profit than a commercial bank, despite charging identical interest rates, or the Bank could earn a profit equivalent to a commercial bank while charging a lower interest rate. Articles 13 and 14 of the Bank's Articles of Agreement, however, make it difficult for the Bank to entertain the latter option of equalizing commercial bank profit while charging a lower interest rate.

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218 Id.

219 See ANTHONY C. GOOCH & LINDA B. KLEIN, ANNOTATED SAMPLE REVOLVING CREDIT AGREEMENT 3 (Roberto G. MacLean & Jeswald W. Salacuse eds., 1994) (A swing-line option allows "a borrower to choose between LIBOR-priced and prime-based loans.").

220 See John E. Mendez, Recent Trends in Commercial Bank Lending to LDCs: Part of the Problem or Part of the Solution, 8 YALE J. WORLD PUB. ORD. 173, 185 n.95 (1982).

221 EUROPEAN BANK FOR RECONSTRUCTION AND DEVELOPMENT, EXTERNAL FINANCING: SYNDICATIONS AND PARTICIPATIONS 2 (1994) (discussing financing for private sector projects) [hereinafter EXTERNAL FINANCING]. See also infra section 3.3.

222 See EXTERNAL FINANCING, supra note 221, at 4.

223 See Agreement, supra note 13, arts. 13-14, 29 I.L.M. at 1089 (stating that the Bank must apply "sound banking principles" in all of its loans).
The Bank has indicated that it may use either fixed or floating interest rates.²²⁴ Fixed rate loans by commercial banks were common in the early 1970s,²²⁵ prior to the Latin American debt crisis. A key feature of contemporary Eurodollar credit transactions is a floating rate based on the LIBOR rate.²²⁶ Commercial banks have shown a preference for floating interest rates when lending to governments of developing countries and, to the extent that commercial banks lend at all to private entities in developing countries, the risks would probably compel them similarly to prefer floating rates in loans to such private entities.²²⁷ Floating interest rates shift the risk of interest rate fluctuation to the borrower,²²⁸ who, as a result, could suffer significant debt costs if the interest rate increases. On the other hand, borrowers could obtain the benefits of decreasing interest rates in a floating rate arrangement.²²⁹

The Bank has indicated that its loan margin “conforms to conditions in the syndicated loan market” and reflects country and commercial risks.²³⁰ This statement indicates that the Bank may be placing various yield protection provisions in its loan agreements, like those typically utilized by commercial banks.²³¹ These yield protection provisions shift certain risks to the debtor, such as the risk of unexpected market occurrence, or the risk of suffering a loss should the Bank deplete its funding because of the borrower’s failure to pay when due.²³² The Bank’s risks will depend on the thinness of its spread. Interest rate provisions may be combined with other provisions, such as

²²⁴ See FINANCING WITH THE EBRD, supra note 14, at 5.
²²⁵ See Mendez, supra note 220, at 185.
²²⁶ See GOOCH & KLEIN, supra note 219, at 1.
²²⁷ See Mendez, supra note 220, at 185-86. Commercial banks are probably lending primarily to key existing corporate customers. See supra notes 20-22 and accompanying text.
²²⁸ See Mendez, supra note 220, at 185.
²²⁹ See id.
²³⁰ FINANCING WITH THE EBRD, supra note 14, at 5.
²³¹ For example, Eurocurrency loan agreements will sometimes contain “yield protection” clauses meant to protect the lender against market and regulatory risks. For a discussion of this yield protection issue, see GOOCH & KLEIN, supra note 219, at 2.
²³² See id. at 2-3.
those governing loan maturities, to allocate further the risks between the borrower and the Bank.\footnote{For example, Eurocurrency loan agreements will sometimes vary the loan maturities to allocate additional risk between the bank and borrower. See id.}

3.1.1.2. Loan Maturities and Repayments

Loan maturities for the Bank’s private sector loans generally range between five and ten years, and repayment of principal normally will be in equal, semi-annual installments.\footnote{See FINANCING WITH THE EBRD, supra note 14, at 5.} Although semi-annual installments are the most common form of repayments,\footnote{See Thomas Moffett, \textit{The Mechanics of Eurodollar Transactions}, in \textit{INTERNATIONAL BORROWING}, supra note 15, at 415, 421.} the Bank will consider longer maturities “on an exceptional basis.”\footnote{See id.} For example, the Bank will consider loan maturities of up to fifteen years for public sector infrastructure projects.\footnote{See Mendez, supra note 220, at 185.} The Bank is essentially in the medium and long term debt market.

The shorter the length of a loan maturity, the less risk the Bank assumes in a credit transaction.\footnote{See id.} The Bank can mitigate its risk of inflation and default through shorter maturities.\footnote{See id.} Moreover, through shorter loan maturities, the Bank can mitigate the risk that its interest spread will become unprofitable.\footnote{See id.} Given the problematic economic conditions in the EBRD countries of operation, the Bank may be tempted to maintain relatively short loan maturities. Maturities which are too short, however, may cause debt servicing problems in these countries, particularly for enterprises that require longer term financing for capital goods.\footnote{See id. at 186 (explaining the concept in the context of public sector loans).}

Article 14, paragraph 3 of the Bank’s Articles of Agreement provides that the Bank’s loans “shall expressly state the currency or currencies, or ECU, in which all
payments to the Bank thereunder shall be made.\textsuperscript{242} The Bank lends in hard currencies, usually the Deutschmark, the United States dollar, or the ECU, and requires that the borrower pay the loans back in the currency in which the funds were originally provided.\textsuperscript{243} The Bank's reliance on hard currencies is, among other things, a reflection of the lack of significant medium-term debt markets in the Bank's countries of operation.\textsuperscript{244} The Bank's approach reflects standard commercial bank practice, although it is on the conservative side, for the Bank could specify that the borrower repay in any hard currency.\textsuperscript{245}

The Bank is exploring methods for loan financing in local currencies.\textsuperscript{246} At the present time, this would seem feasible only for short-term debt in relatively small amounts. The Bank, however, has set its minimum lending requirement at 5 million ECUs.\textsuperscript{247} The Bank, moreover, is not interested in making direct loans to small and medium sized enterprises, preferring instead to finance such enterprises through intermediaries.\textsuperscript{248} Thus, the Bank's own policies may limit its options with regard to lending in the currencies of the borrowing countries. The Bank may be able to lend to small and medium-sized enterprises in short term local currency loans where swift payback on the investments can be conservatively identified, such as in the instance of great demand for a certain product manufactured by an enterprise, for example.

3.1.1.3. Fees and Expenses

Article 15 of the Bank's Articles of Agreement requires the Bank to establish and charge fees and expenses for its operations.\textsuperscript{249} The Bank charges the borrower various

\textsuperscript{242} Agreement, supra note 13, art. 14(3), 29 I.L.M. at 1089.
\textsuperscript{243} See FINANCING WITH THE EBRD, supra note 14, at 4-5.
\textsuperscript{244} See id. at 5.
\textsuperscript{245} This point was suggested by Professor Peter Fox.
\textsuperscript{246} See FINANCING WITH THE EBRD, supra note 14, at 5.
\textsuperscript{247} See id. at 4.
\textsuperscript{248} See id. These intermediaries would provide credit lines, guarantees, equity funds, and early stage capital. The environmental conditions placed upon such intermediaries are discussed supra in section 2.1.1.5.
\textsuperscript{249} See Agreement, supra note 13, art. 15, 29 I.L.M. at 1090.
fees and expenses for administration of the loan, for technical consultants, and for outside legal counsel. At the time of loan execution, the Bank charges a "front-end fee" to cover its administrative expenses. The Bank's fee and expense allocations to the borrower are generally in accordance with commercial practice. These fees reduce the Bank's risk by allowing the Bank to recover some of its costs and profits very early in the loan cycle. On the other hand, fees and expenses increase the costs of borrowing for the enterprises served by the Bank.

3.1.1.4. Recourse

The Bank may engage in recourse financing, nonrecourse financing, or limited-recourse financing. For limited-recourse financing, the Bank may seek from project sponsors performance and completion guarantees, as well as other forms of support, "of the kind that are normal practice in limited-recourse financings." The Bank, however, will not seek governmental guarantees for loans to private sector enterprises, including newly privatized state enterprises. In this respect, the Bank interprets its Articles of Agreement to provide it with the option of seeking a guarantee only when the borrower is a state enterprise. The Bank's "fundamental goal" is the development of a strong private sector. The Bank has adopted the approach of the International Finance Corporation.

The Bank has been developing nonrecourse project financing methods, which "will reduce reliance on government borrowing or guarantees," in order to minimize
southern debt. One example is the Bank's use of the Build-Operate-Transfer method of project financing.

3.1.1.5. Security

When the Bank requires security, it typically will require that the security be on the borrower's assets. Security based on project assets may include a mortgage on fixed assets, such as land, plant, and buildings, or a mortgage on movable assets, such as equipment. The Bank may also secure a loan through assignment of the hard and local currency earnings of an enterprise, a pledge of the sponsor's equity, or the assignment of insurance proceeds or other contract proceeds.

A mortgage, however, is effective only to the extent of the adequacy of applicable laws and legal system. Even though a mortgage may not adequately protect the Bank's interest, the Bank may obtain a mortgage on assets in order to preclude the borrower from granting security interests to others, a standard approach in project finance. In these circumstances, it is also standard for the lender to obtain a pledge of the borrower's equity, as well as an assignment of proceeds or an assignment of rights either to operate the asset or to sell it to a third party. The Bank has indicated that it will usually require its borrowing companies to secure the loan with project assets; the Bank has not expressed an interest in obtaining rights to operate the assets or to sell them to third parties, presumably because it does not want to become involved in project operations. This policy of non-involvement is prudent — the Bank should be involved in banking, not in running projects.

The Bank may have other reasons for taking mortgages.

\[\text{Newburg, supra note 201, at 436.}\]
\[\text{See id.}\]
\[\text{See FINANCING WITH THE EBRD, supra note 14, at 6.}\]
\[\text{See id.}\]
\[\text{See Robert S. Rendell, International Project Financing, in INTERNATIONAL FINANCIAL LAW, supra note 217, at 39, 47.}\]
\[\text{See id.}\]
\[\text{See FINANCING WITH THE EBRD, supra note 14, at 6.}\]
For example, the Bank may want to express confidence in the legal systems of the borrowing countries. The Bank, however, may only rely on such security devices in countries with legal systems in which it already has some degree of confidence. In an attempt to enhance its confidence in the legal systems of its borrowing countries and because secured transactions laws in its countries of operations have tended to be either nonexistent or insufficient, the Bank has prepared a Model Law on Secured Transactions for consideration.\footnote{See EUROPEAN BANK FOR RECONSTRUCTION AND DEVELOPMENT, MODEL LAW ON SECURED TRANSACTIONS (1994).}

3.1.1.6. Covenants

As to covenants placed in its private sector loans, all that the Bank makes public is that “[t]ypical project finance covenants are required as part of the loan package [and] such covenants, limiting indebtedness, specifying certain financial ratios and other various issues, will also be negotiated as appropriate to the loan.”\footnote{FINANCING WITH THE EBRD, supra note 14, at 6.} The Bank does not make any sort of standard loan terms and conditions for its private sector projects available to the public.\footnote{See Memorandum, supra note 211.} This is consistent with the practice of the International Finance Corporation, and with the Bank’s role as a merchant banker in its private sector projects.\footnote{An evaluation of typical project finance covenants is beyond the scope of this Article.}

3.1.2. Important Loan Policies

Bank financing is governed by thirteen operating principles which are set forth in Article 13 of the Bank’s Articles of Agreement. The most notable principles are that the Bank must apply “sound banking principles to all its operations”\footnote{Agreement, supra note 13, art. 13(i), 29 I.L.M. at 1089.} and invest on financial “terms and conditions which it considers appropriate, taking into account . . . the terms and conditions normally obtained by private investors for similar financing.”\footnote{Id. art. 13(xi), at 1089.}
Finance Corporation, which the EBRD resembles more closely than the World Bank, is not bound by such requirements.\(^{270}\) The “sound banking principles” provision, moreover, is not easily reconciled with the principle of subsidiarity, which is set forth in Article 13 as well. The principle of subsidiarity prohibits the Bank from undertaking any financing when the applicant is able to obtain sufficient financing from other sources on terms and conditions that the Bank considers reasonable.\(^{271}\)

These inconsistent Article 13 principles present the Bank with a puzzling problem.\(^{272}\) If a commercial bank cannot make an investment because it would violate sound banking principles, how is the EBRD to make the investment? One solution may be to interpret the term “sound banking principles” as including sound “development banking” principles.\(^{273}\) Under the 1969 Vienna Conventions on the Law of Treaties, a treaty should be interpreted “in good faith in accordance with the ordinary meaning” of its provisions, and treaty provisions should be given the meaning that is in their proper context and in accordance with the “object and purpose” of the treaty.\(^{274}\) It would seem that “sound banking principles” could not be interpreted to mean sound “development banking” principles for the merchant banking side of the Bank. Such an interpretation would be inconsistent with the sixty-forty, private-public sector distinction set forth in the Bank’s Articles of Agreement.\(^{275}\) It would also deprive of significance those Articles that require the Bank to safeguard its income\(^{276}\) and to lend on terms and conditions normally obtained in the private sector for similar investments.\(^{277}\)

\(^{270}\) See Dunnett, supra note 204, at 589 n.35.

\(^{271}\) See Agreement, supra note 13, art. 13(vii), 29 I.L.M. at 1089.

\(^{272}\) For the Bank’s explanation of how to reconcile this inconsistency, and for a further discussion generally on this issue, see Linarelli, supra note 10, at 387-88.

\(^{273}\) This point was suggested by Professor Peter Fox.

\(^{274}\) Law of Treaties, art. 31, supra note 190, 8 I.L.M. at 691-92.

\(^{275}\) See supra text accompanying notes 31, 122, 159, and 202; infra text accompanying note 279.

\(^{276}\) See supra notes 213-14 and accompanying text.

\(^{277}\) See supra note 215 and accompanying text.
3.2. Public Sector Lending

In the area of public sector lending, several notable issues emerge. These issues include the limitations on the scope of the EBRD’s public sector lending to development of market infrastructure, whether EBRD public sector loans create internationally binding obligations, and the problematic nature of the Bank’s prohibition on policy-based lending.278

3.2.1. Infrastructure Development Financing as International Obligation

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,279 and that this public sector financing is limited to the purpose of developing infrastructure needed for market-oriented economies.280 Infrastructure...
ture development is of vital importance to the countries in transition from socialism, and the Bank’s development banking functions may be more important than initially thought by the Bank and its founders.  

In pursuit of this infrastructure development priority, a key question emerges: are the public sector loan and guarantee agreements of the EBRD international obligations? While the loan and guarantee agreements of the World Bank convincingly merit this status, it is much less clear in the case of the EBRD.

When analyzing the treaty-making power of an international organization such as the EBRD, the international legal personality of the organization does not necessarily result in the authority to make treaties. The Bank’s Articles of Agreement must be examined and treaty-making power may be implied by resorting to methods of interpretation of the Articles of Agreement. The EBRD’s Articles of Agreement authorize loan agreements between the Bank and states and between the Bank and state enterprises, as well as co-financing techniques involving both private parties and other international organizations.

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See SHIHATA, A COMPARATIVE ANALYSIS, supra note 36, at 61-62 (emphasis in original).

See Linarelli, supra note 10, at 390 (quoting Ibrahim Shihata in the context of World Bank priorities). As suggested by Professor Peter Fox, the concept of market infrastructure could also encompass certain “natural” monopolies that may or may not be in transition to privatization. Examples are monopolies in telecommunications, ports, airports, railroads, power generation and distribution, and utilities. Some of these monopolies may be demonopolized and subjected to competition in the future, while others may not. See SHIHATA, SELECTED ESSAYS, supra note 127, at 30 (stating that eliminating or reducing public monopolies increases the scope of private activities). The Bank’s approach to this issue is to maximize competition and privatization. For example, the Bank’s operational policy for telecommunications is to stress eventual privatization of virtually everything except local telephone service. See TELECOMMUNICATIONS POLICY, supra note 177, at 16.

See Brownlie, supra note 190, at 683-84.

See id.

See Agreement, supra note 13, art. 11(1), 29 I.L.M. at 1087-88.
The Bank's direct agreements with states, in all likelihood, are treaties, just as the World Bank's direct agreements with states are treaties. The Bank's agreements with state enterprises, however, would not be treaties because the borrowers of such loans are not the subjects of international law. The World Bank, to some extent, sidesteps this problem because its Articles of Agreement mandate government guarantees for all of its loans, and the government is a joint debtor, not merely a surety. Government guarantees for EBRD loans, however, are voluntary, and indeed are discouraged, so as to provide incentives for private sector development. Thus, at most, EBRD loans to state enterprises may be treaties only to the extent that the EBRD obtains a government guarantee that makes the sovereign a joint debtor. This may likely be a small subset of EBRD loans.

In the context of determining the legal character of EBRD loan agreements, the EBRD is more like the European Investment Bank ("EIB"), which also has discretion to seek government guarantees. The EIB, unlike the EBRD, however, makes its agreements subject to municipal law.

As for syndications and syndicated participations in public sector loans by private sector entities such as commercial banks, the analysis would be similar to that for state enterprises as borrowers, since commercial banks also lack international legal personality. It would seem to be an extreme stretch to characterize an agreement in which a commercial entity is a party as a treaty. In the appropriate circumstances, the loan agreement may constitute a treaty, while separate documentation for participation may not. The situation may become even more interesting when an international organization, such as the World Bank,

\[285\] Broches, Selected Essays, supra note 189, 32-34.
\[286\] See id. at 38.
\[287\] See id.
\[288\] See Shihata, A Comparative Analysis, supra note 36, at 63-64.
\[289\] See Broches, Selected Essays, supra note 189, at 41.
\[290\] See id.
\[291\] For a discussion of the EBRD's engagement in syndication and syndicated participation, see Linarelli, supra note 10, at 384.
participates in a loan or is a co-financier.

That the EBRD's loans may or may not be treaties does not mean that, like the EIB, EBRD loans are governed by municipal law. The Bank's Standard Terms and Conditions for public sector loans reflect the World Bank's practice in specifying international law as applicable to the loan agreement, and by declaring that the loan terms and conditions take precedence over municipal law.\(^{292}\) Section 8.01 of the EBRD's Standard Terms and Conditions provides as follows:

The rights and obligations of the parties to the Loan Agreement and the Guarantee Agreement shall be valid and enforceable in accordance with their terms notwithstanding any local law to the contrary. No party to either such agreement shall be entitled under any circumstances to assert any claim that any provision of either such agreement is invalid or unenforceable for any reason.\(^{293}\)

Section 8.04, governing dispute resolution, discusses international arbitration and specifies the following choice of law:

The law to be applied by the arbitral tribunal shall be public international law, the sources of which shall be taken for these purposes to include:

(A) any relevant treaty obligations that are binding reciprocally on the parties;
(B) the provisions of any international conventions and treaties (whether or not binding directly

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\(^{293}\) \textit{EBRD Standard Terms and Conditions}, \textit{supra} note 65, § 8.01.
as such on the parties) generally recognised as having codified or ripened into binding rules of customary law applicable to states and international financial institutions, as appropriate; (C) other forms of international custom, including the practice of states and international financial institutions of such generality, consistency and duration as to create legal obligations; and (D) applicable general principles of law.  

Moreover, EBRD public sector loan agreements contain provisions addressing matters not usually dealt with by private parties, such as access to territories, tax exemptions, public procurement rules, and exemptions from foreign exchange restrictions.

The above provisions, in appropriate circumstances, could support the treatment of the Bank's public sector loan agreements as treaties. Aron Broches, in the context of the World Bank, has asserted that an agreement with such provisions is governed by international law, and "that it is only in an agreement between subjects of international law that the application of municipal law can be wholly excluded." The Bank and non-sovereign parties to its loan agreements may not be in the position to exempt wholly their agreements from municipal law, since all sides to the transaction may not be subjects of international law. It is unknown whether we will see any publicly available court decisions on this issue because the Bank's Standard Terms and Conditions contain a dispute resolution clause requiring arbitration.
3.2.2. Prohibition on Structural and Sectoral Adjustment Loans

Unlike the World Bank, the EBRD cannot make structural adjustment, sectoral-adjustment, or policy-based loans.\textsuperscript{298} Article 13(ii) of the Bank's Articles of Agreement provides that "the operations of the Bank shall provide for the financing of specific projects, whether individual or in the context of specific investment programmes . . . ."\textsuperscript{299} The Explanatory Notes for Article 13, at paragraph 3, provide that "[i]n sub-paragraph (ii), Delegates described the precise form of programme lending in which the Bank could become involved as 'projects, whether individual or in the context of specific investment programmes,' so as to make clear that fast-disbursing policy-based lending is not included."\textsuperscript{300}

The interpretation of the Articles of Agreement, as expressed in the Explanatory Notes to the Agreement, is restrictive.\textsuperscript{301} The World Bank has interpreted its Articles of Agreement to allow for structural adjustment lending, and since the early 1980s the World Bank has engaged in such lending.\textsuperscript{302} The World Bank's Articles of Agreement provide, however, that "[l]oans made or guaranteed by the Bank shall, except in special circumstances, be for the purpose of specific projects of reconstruction or

\textsuperscript{298} See SHIHATA, A COMPARATIVE ANALYSIS, supra note 36, at 53; Hurlock, supra note 280, at 372. Policy-based loans, which are typically fast-disbursing, are loans made to promote structural or sectoral reform in a country. See Cahn, supra note 16, at 171. They are often made to finance the reduction of a country's balance of payments deficit. See SHIHATA, A COMPARATIVE ANALYSIS, supra note 36, at 43. Policy-based loans are usually made on the basis of conditionality — that the country implement certain reforms aimed at inflation, public deficits, restrictive trade and investment laws, exchange rate restrictions, land reform, and tax reform. See Dominique Carreau, Why Not Merge the International Monetary Fund (IMF) With the International Bank for Reconstruction and Development (World Bank)?, 62 FORDHAM L. REV. 1989 1999-2000 (1994).

\textsuperscript{299} Agreement, supra note 13, art. 13(ii), 29 I.L.M. at 1089.

\textsuperscript{300} EXPLANATORY NOTES, supra note 34, at 57.

\textsuperscript{301} This was point suggested by Professor Peter Fox.

\textsuperscript{302} See SHIHATA, SELECTED ESSAYS, supra note 127, at 25-27.
The clarification in the Explanatory Notes sets forth the intent of the founders of the Bank. In negotiating the Bank’s Articles of Agreement, France proposed that the EBRD have the ability to make policy-based loans in order to promote macroeconomic reform.\textsuperscript{304} Other countries, including the United States, argued that the World Bank and the IMF already were making policy-based loans in the region, and that these organizations possessed the technical expertise to deal with these difficult loans.\textsuperscript{305} The latter position carried the day, and the EBRD is thus limited to making project-based loans.\textsuperscript{306}

This narrow interpretation of the EBRD’s Articles of Agreement which prohibits policy-based lending, may restrict the future evolution of the EBRD, and may inhibit the EBRD’s ability to remain a vital institution.\textsuperscript{307} The World Bank has engaged in an evolution toward policy-based lending in response to changing world needs with no apparent deleterious effects, although the World Bank does have its critics.

The lack of policy-based lending power by the Bank reflects a serious flaw in the Bank’s charter.\textsuperscript{308} The Bank’s attempt at market infrastructure investments could be seriously hampered by lack of authority to make policy-based loans.\textsuperscript{309} The counter-argument is that the EBRD restriction on policy-based lending is appropriate, and that other development institutions should not provide these policy-based loans either. Perhaps the prohibition serves to mitigate conflict in a politically unstable region where it is quite difficult to make policy-based loans in an even-handed

\textsuperscript{303} Articles of Agreement for the International Bank for Reconstruction and Development, \textit{supra} note 5, art III(4)(7), 60 Stat. at 1444, 2 U.N.T.S. at 144.
\textsuperscript{304} See Weber, \textit{supra} note 34, at 17-18.
\textsuperscript{305} See \textit{id}.
\textsuperscript{306} See \textit{id}. at 18.
\textsuperscript{307} This point was suggested by Professor Peter Fox.
\textsuperscript{308} For a further discussion on the EBRD’s lack of power to engage in policy-based lending, see Linarelli, \textit{supra} note 10, at 394-95.
\textsuperscript{309} See \textit{id}. at 395. Indeed, the Bank’s activities in sectors, particularly in the financial sector, suggests that the Bank may be involved in some form of disguised or \textit{de facto} sectoral adjustment lending.
manner, or at least that may be the perception.\textsuperscript{310} The issue is whether development banks should finance “social” loans from the public external debt markets when governments refuse to do so, or when governments do not have the means to provide budgetary resources for the social programs in question. Moreover, increased economic productivity as a result of such lending is questionable. Some of these arguments raise imponderable questions that may not need to be answered in the context of the EBRD in any event, since the EBRD may not have the financial wherewithal to make appreciable policy-based loans, given its relatively small size in comparison to the World Bank.\textsuperscript{311}

In the regions served by the Bank, there is a need for an institution that will take the lead with respect to policy-based loans. It is unknown whether the IMF will take on an active role in the long term particularly given the poor precedent of the Latin American debt crisis. Recently, however, the Fund made a U.S. $6.4 billion loan to the Russian Federation, which includes monthly, rather than the usual quarterly, disbursements by the Fund.\textsuperscript{312} This loan is based on numerous conditions intended to promote economic reform in Russia, including the reform of Russia’s energy sector.\textsuperscript{313} The World Bank, moreover, recently approved a loan to the Russian Federation, in an amount equivalent to U.S. $500 million, for the reform of the country’s petroleum sector.\textsuperscript{314} Adjustment lending in the regions served by the EBRD should be closely coordinated among the multilateral development institutions.\textsuperscript{315}

3.3. Preferred Creditor Status?

The Bank has made the claim to “preferred creditor

\textsuperscript{310} This point has been suggested by Professor Peter Fox.

\textsuperscript{311} These counterarguments were suggested by Peter Fox.

\textsuperscript{312} Steven Erlanger, I.M.F. Agrees to Give Russia $6 Billion Loan, N.Y. TIMES, Mar. 11, 1995, at 4; Russia and the I.M.F.: Fingers Crossed, ECONOMIST, March 11, 1995, at 50.

\textsuperscript{313} Erlanger, supra note 312, at 4.

\textsuperscript{314} INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT, STAFF APPRAISAL REPORT, RUSSIAN FEDERATION SECOND OIL REHABILITATION PROJECT (June 13, 1994).

\textsuperscript{315} See Linarelli, supra note 10, at 395.
status. The Bank attempts to mobilize private sector funds by not involving itself in debt reschedulings for loans to, or guarantees by, member countries. Nor will the Bank 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. There are several reasons why the Bank's declaration of its status as a preferred creditor is questionable.

The term "preferred creditor" is not a term of art in international law. A noncontroversial definition of the term is as follows:

[The term "preferred creditor" refers to external creditors of sovereign States who are legally entitled to be given priority among individual creditors or classes of creditors in relation to the settlement of external debt. The term will be used only in relation to creditors who are international persons (i.e. sovereign States and international organizations) and whose priority claims are founded on international law. The corresponding debts that enjoy such treatment have been called preferential debts, i.e. those debts which are wholly or proportionally payable in preference to others.

Under this definition, the EBRD would be a preferred creditor only when acting as a creditor to a state. For transactions with states, the EBRD also would have to show that it is legally entitled to such a priority. Since there is no settled international law on the issue of legal entitlement to a priority, the question must be answered by reference to the terms and conditions of loan agreements, or

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316 See FINANCING WITH THE EBRD, supra note 14, at 4.
317 See id. at 4; EXTERNAL FINANCING, supra note 221, at 4.
318 See EXTERNAL FINANCING, supra note 221, at 4.
320 Id. at 806.
perhaps by reference to the Articles of Agreement of the Bank. Neither the Bank's Articles of Agreement nor its Standard Terms and Conditions provide the requisite designation associated with preferred creditor status. The EBRD's negative pledge clause does not establish a priority, it merely establishes equality of treatment among creditors.\textsuperscript{21} The Bank, however, has made a preferred creditor declaration in its non-contractual documentation.\textsuperscript{22}

The Bank syndicates loans for private and public sector borrowers.\textsuperscript{23} The World Bank, moreover, has been involved in syndications of loans made to sovereigns.\textsuperscript{24} The World Bank's documentation for these loans exempts them from sovereign debt restructuring.\textsuperscript{25} This exemption is controversial, even for the World Bank, which makes only public sector loans.\textsuperscript{26} It surely is an even more controversial issue for the EBRD, particularly with respect to its private sector loans.

It would appear that the most prudent route for the Bank to take in order to ensure preferred creditor status would be to require a binding agreement from its borrowers to this effect. The Bank's unilateral statements that it has preferred creditor status will not make it so.\textsuperscript{27} It would not be prudent for the Bank to rely on any sort of emerging norm or \textit{opinio juris} on the subject, even though it has been

\begin{footnotes}
\footnote{See id. at 806-07.}
\footnote{See \textsc{EXTERNAL FINANCING}, supra note 221, at 4; \textsc{FINANCING WITH THE EBRD}, supra note 14, at 5; \textsc{TRANSPORT SECTOR}, supra note 171, at 37-38. \textit{Cf.} Case c-221/88 European Coal and Steel Community v. Acciaierie e ferriere Busseni SpA, in which the Court of Justice of the European Communities held, pursuant to a European Coal and Steel Community Commission ("ECSC") recommendation, that the ECSC was entitled to provide itself with a form of preferred creditor status in bankruptcy cases within EC Member States. The case is distinguishable because of its basis in Community law. The EBRD is not, in the formal legal sense, a Community institution under the relevant treaties.
\footnote{See supra note 291 and accompanying text.}
\footnote{See Keith Clark, \textit{Sovereign Debt Restructurings: Parity of Treatment Between Equivalent Creditors in Relation to Comparable Debts}, 20 INT'L LAW. 857, 859 (1986).
\footnote{See id.}
\footnote{See supra note 319, at 816.}
\end{footnotes}
a matter of practice, or at least an untested assumption, and accepted by the Paris Club, sovereign nations, commercial creditors, and development bank creditors for many years.\footnote{328} 


This Article explores one of the important ways in which the West has set out to provide aid in a multilateral context to countries in desperate need.\footnote{329} In the post-Cold War order, distinctions between the “political” and the “economic” are disintegrating.\footnote{330} The United States, for example, has sought to link trade and human rights concerns in its dealings with other countries.\footnote{331} The Tiananmen Square incident severely constrained China’s ability to trade with many countries, as well as its ability to secure loan assistance from the World Bank.\footnote{332} Indeed, in the countries served by the EBRD, human rights violations by communist governments significantly impeded economic growth.\footnote{333} With its emphasis on conditionality, the EBRD can thus be viewed as promoting a new paradigm in multilateral development institutions.

The EBRD’s perceived success or failure will not depend solely on its own efforts. Even more important factors may be whether international markets are open for goods and services of the countries that the EBRD serves, and whether the countries that the EBRD serves can successfully penetrate such open markets with their goods and

\footnote{328}{\footnotesize See Hurlock, supra note 280, at 365-66. See generally Martha, supra note 319.}
\footnote{329}{\footnotesize It should be noted that the World Bank, the International Finance Corporation, and the Asian Development Bank also maintain operations in some of the same countries as the EBRD. This point has been suggested by Professor Peter Fox.}
\footnote{330}{\footnotesize See Marshall Sonenshine, Time for a Profitable Advance on Human Rights, FIN. TIMES, Aug. 21, 1990, at 15.}
\footnote{332}{\footnotesize See Sonenshine, supra note 330, at 15.}
\footnote{333}{\footnotesize See id. (stating that repression of civil liberties undeniably lessened productivity and initiative in the formerly communist nations).}
services. Capital transfers must result in net transfers of wealth, and the success of the borrowing countries in reconstruction and development depends, in a significant way, on their ability to export their products. Concerns about overly burdensome debt obligations would be nullified, or at least mitigated, by increased gross national product caused by increased exports. Debt becomes a problem when it cannot be managed by a country, and the serviceable debt of one country is the “debt crisis” of another.

The argument that there would be insufficient demand for additional products added to the international marketplace by these countries in transition from socialism should not be of great concern, as it reflects what economists call the “lump-of-production fallacy.” As stated by one writer:

Global production and consumption are not somehow fixed. Trade increases the output that can be squeezed from any given collection of resources, and the consumption that can be obtained from any given set of production possibilities. The parties at both ends of the transaction profit. Trade is, in short, a positive-sum game.

In the context of regional policy, the transitional countries

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334 See Clive Crook, The Gains from Trade, A SURVEY OF THE THIRD WORLD 25, in ECONOMIST, Sept. 23, 1989 (citing to insert) [hereinafter Crook, Gains from Trade].
335 See Clive Crook, Distracted by Debt, A SURVEY OF THE THIRD WORLD 51, in ECONOMIST, Sept. 23, 1989 (citing to insert) [hereinafter Crook Distracted by Debt]; see also Crook, Gains from Trade, supra note 334, at 25.
336 See Crook, Distracted by Debt, supra note 335, at 51-52.
337 Id.
338 See Clive Crook, How to Leap a Frontier, A SURVEY OF THE THIRD WORLD 27, 33, in ECONOMIST, Sept. 23, 1989 (citing to insert) (stating that although some have argued that additional exports by developing countries will lead to protectionist measures in the targeted markets, an exporter’s success depends less upon demand than upon supply-side efficiency).
339 Id. at 34.
340 Id.
served by the Bank have no real choice other than to compete in the global marketplace in order to maintain any possibility of increasing their respective gross national products.

The reconstruction and development of the countries in question will ultimately be unsuccessful in the absence of open trade policies in the West, particularly in Europe.\textsuperscript{341} As demonstrated by the economic success stories of Japan, Taiwan, and Korea, it is unlikely that these countries will be able to accomplish their transitions without open markets. Without open trade regimes, the massive economic problems of the Bank's countries of operations will only be aggravated,\textsuperscript{342} thus hindering the transition from socialism to democracy and continuing or worsening their problems with macroeconomic reform.

In response to the need for open trade policy, the North American Free Trade Agreement ("NAFTA") provides the germ of an idea — the evolution of trade agreements in preeminence over aid institutions. Some countries in the Western Hemisphere have considered the expansion of NAFTA to Chile and eventually to a significant portion of Latin America. Although the emphasis in the Western Hemisphere is on economic, and not political, integration, the enhancement of democratic public order in the Western Hemisphere will flow from productive linkages of political and economic concerns. As demonstrated by NAFTA, the current trend focuses on trade liberalization as the primary mover toward long-term reform. The Latin American debt crisis has, in all likelihood, played an important role in the shift in focus. Of course, analogizing to the Western Hemisphere is not perfect for a number of reasons, including the fact that Latin America is now much better off, economically and politically, than the EBRD borrowing countries, and the fact that the Inter-American Development Bank and the World Bank have long played roles in...
Latin America. Some, however, have suggested that development institutions did more harm than good in Latin America.  

In contrast to the economic inter-American approach, the European approach places greater emphasis on political integration. Jacques Attali, the first president of the EBRD and one of the sources for the idea of a regional development institution for Central and Eastern Europe, has said the EBRD is an “embryo for a European confederation.” Increasing membership in the EU may shift the source of aid away from the EBRD and programs such as PHARE into a regional aid structure that includes the EIB. Aid without substantial trade liberalization prior to EU membership may ultimately create EU Member States that are impoverished in comparison to other Member States and that require aid in merely another form. One preeminent goal should be to increase economic wealth in the countries served by the EBRD, which is most effectively accomplished through substantial trade liberalization.

The EU has by no means ignored the trade aspects of its relationship with Central and Eastern Europe. Liberalized trade with countries outside of the EU, however, would be inconsistent with the concept of the internal European market. The Union has abolished quantitative trade restrictions for certain products of some countries, such as Hungary, Poland, and Bulgaria. The EU has granted

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343 See generally, Paulo R. de Castro, Brazilian Hyperstagflation: The Case Against Intervention, in PERPETUATING POVERTY, supra note 341, at 187-210; Robert S. Leén, Mexico, Markets, and Multilateral Aid, in PERPETUATING POVERTY, supra note 341, at 165-85; Paul C. Roberts, Development Planning in Latin America: The Lifeblood of the Mercantilist State, in PERPETUATING POVERTY, supra note 341, at 147-63. The existence of the Inter-American Development Bank was suggested by Peter Fox.

344 Dunnett, supra note 204, at 574 (quoting French television interview, Mar. 25, 1991).


346 See van Gerven & Suami, supra note 97, at 152.
trade preferences under the Generalized System of Preferences of the General Agreement on Tariffs and Trade to only a few countries in Central and Eastern Europe, although coverage may expand in the future.\textsuperscript{347} The Generalized System of Preferences, in this author's opinion, however, has provided few benefits to developing countries. The EU has also entered into association agreements with the Visegrad states of Hungary, Poland, and Czechoslovakia,\textsuperscript{348} while individual Member States have entered into various bilateral trade agreements with Central and East European states. Jacques Attali, however, has "called for the EC's association agreements with Poland, Hungary and Czechoslovakia to be torn up and renegotiated."\textsuperscript{349}

The Bank can attempt to promote the important goal of trade liberalization in several ways. First, given the Bank's nature as a development institution, its efforts can be efficacious on the "supply side" by developing the infrastructure necessary for export-oriented industries. Second, the Bank can continue concentrating on the reform of the financial and banking sectors in its countries of operations.\textsuperscript{350} This financial and banking emphasis is a key priority for the Bank, intended to expand capital markets for the fledgling enterprises in the Bank's countries of operations. Third, the Bank can involve itself in legal reform in its countries of operations. A regular and predictable system of laws and courts is necessary for economic development, particularly in attracting foreign investment. Finally, because many of the enterprises in the EBRD-served countries do not make products of sufficient quality to be competitive,\textsuperscript{351} the Bank can focus on industrial and manufacturing sector programs designed to increase the international competitiveness of products made by EBRD-

\textsuperscript{347} See id. at 152-53 (stating that the EU proposed an extension of such trade preferences to all PHARE beneficiaries in 1991).
\textsuperscript{348} The Agreement with Czechoslovakia is subject to renegotiation due to the split of the country into the Czech Republic and Slovakia. See Spector, supra note 345, at 353-54.
\textsuperscript{349} Thunder Off, ECONOMIST, Sept. 12, 1992, at 48, 51.
\textsuperscript{350} See 1993 ANNUAL REPORT, supra note 24, at 7; see also FINANCIAL SECTOR OPERATIONS, supra note 177.
\textsuperscript{351} See GERHARD POHL & PIRITTA SORSA, EUROPEAN INTEGRATION AND TRADE WITH THE DEVELOPING WORLD 54 (1992).
served countries. It will remain the predominant function of sovereign states, however, to deal with the “demand side” by ensuring open markets for competitive products from the borrowing countries of the EBRD.

5. CONCLUSION

Several conclusions emerge from this Article. First, discourse or inquiry should be distinguished from action.\(^5\) From the perspective of inquiry, the EBRD is indeed a remarkable multilateral institution. It could not have been created at the time of Bretton Woods, or, for that matter, at any time during the Cold War. The importance of the institution per se, in terms of its potential impact on the development of international or supranational norms, may be significant.\(^3\)

Second, the Bank is a significant and recent manifestation of multilateralism. There have been three manifestations in multilateralism, in the areas of trade, aid, and politics. The Bank predominantly reflects multilateralism in the aid realm, as well as the political realm.\(^4\) Other significant manifestations of multilateralism in the political realm are the post-Cold War United Nations Security Council activities, the CSCE, and the EU. There is a confluence of interest between the Bank’s political conditionality and the EU’s political criteria for membership.\(^5\) The Bank’s political mandate ultimately should reinforce country efforts to join the EU.\(^6\)

Third, from the perspective of action, the Bank is constrained to provide aid in a manner substantially similar to that provided by the existing multilateral financial institutions. The Bank is constrained further by its capital base which makes it smaller than the World Bank. The

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353 See Head, supra note 9, at 606.
354 See supra section 2.2.
356 See id.
Bank nonetheless serves a vital capital-accessing function for its borrowing countries. This function is accomplished by the Bank’s role as a “catalyst” or “demonstrator” for private sector investment in its borrowing countries, and in its role in developing the infrastructure necessary for market economies. The Bank’s capital-accessing function, however, must be coupled with economic incentives for the countries in which the Bank operates, such as trade liberalization. Aid without open international trading regimes for the EBRD-served countries is insufficient for economic, as well as political, development. The transitional countries at issue need economic expansion, for economic expansion is vital in avoiding a debt crisis similar to that experienced by Latin American countries in the 1980s.

Fourth, the Bank’s political conditionality is a significant legal construct, but may not have real long run effects in the borrowing countries. It is the possibility of EU membership that will be the strongest motivation for countries to ensure democracy, political pluralism, and respect for human rights. The Bank’s Articles of Agreement are contemporary in approach and, in any event, are consistent with current development economics theories. Although the Bank has taken on its political tasks primarily by monitoring the political developments of its borrowing countries, the Bank’s political mandate provides it with the discretion necessary to avoid the debacles that the World Bank experienced when it made loans to countries with governments accused of human rights violations.

Finally, the Bank’s Articles of Agreement expressly set forth the mandate of sustainable development. Environmental concerns are paramount in today’s development scene and the borrowing countries of the EBRD have suffered particularly from a history of incredible environmental devastation. The EBRD has taken on an assertive role in applying its environmental conditionality. The EBRD has the unique opportunity to develop pan-European approaches to dealing with the environment.

It is too early to assess the impact of the EBRD. Its

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357 See supra section 3.2.1.; Linarelli, supra note 10, at 389-91.
private sector mandate, however, may have effects beyond the specific projects that it undertakes. The Bank, with its approach to development that requires political and economic freedom, as well as sustainable development, may present the world with a positive model for international development institutions. Let us hope that the Bank succeeds in its mission.