

# Reinvention or Restoration?

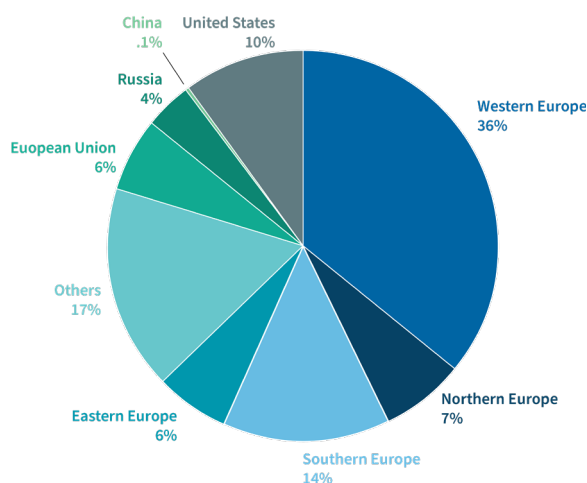
## *The Future of the European Bank for Reconstruction and Development*

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As the Iron Curtain came down in 1991, European countries sought to turn the page on the Cold War and march toward a new era that championed free markets, private sector-driven growth, peace, and stability. In that context, the European Bank for Reconstruction and Development (EBRD) came into existence with a mandate to create strong and sustainable market institutions in the post-Communist Central and Eastern European (CEE) countries and to enable the growth of free enterprises and the private sector. Founded in April 1991, the EBRD had 40 members in its original constitution (Figure 1) and had the support of the European Investment Bank (EIB) and the European Economic Community (presently known as the European Union).<sup>1</sup>

Figure 1: Shareholding Percentage (as of 2018)



Source: “EBRD Shareholders and Board of Governors,” EBRD, <https://www.ebrd.com/shareholders-and-board-of-governors.html>.

1. “History of the European Bank for Reconstruction and Development (EBRD),” European Bank for Reconstruction and Development (EBRD), [www.ebrd.com/who-we-are/history-of-the-ebrd.html](http://www.ebrd.com/who-we-are/history-of-the-ebrd.html).

For many post-Communist countries, the lingering legacy of a state-controlled economy meant that the traditional forms of private-sector investments were absent. In the years following the collapse of Communism, the issue of state-owned enterprises dogged the efforts of many countries as they attempted to build capitalist economies. State-owned enterprises employed tens of millions of people and therefore could not be shut down unilaterally without destabilizing effects, making them resistant to market reforms.<sup>2</sup> The radical economic liberalization policies involving ending price and currency controls, opening up countries to trade, and removing unproductive state subsidies also shocked these young democracies struggling to build public trust in their institutions.<sup>3</sup> Given these complexities, the EBRD was tasked with promoting, supporting, and providing private investments, strengthening the domestic resource mobilization capacities of its member countries, providing public-sector entities with technical assistance on project finance management, and deepening local capital markets.<sup>4</sup>

Table 1: Founding Members of the EBRD

<i>FOUNDING MEMBERS OF THE EBRD</i>			
<i>European Communities</i>	<i>Other European Countries</i>	<i>Recipient Countries</i>	<i>Non-European Countries</i>
<i>Belgium</i>	<i>Austria</i>	<i>Bulgaria</i>	<i>Australia</i>
<i>Denmark</i>	<i>Cyprus</i>	<i>Czechoslovakia</i>	<i>Canada</i>
<i>France</i>	<i>Finland</i>	<i>German Democratic Republic</i>	<i>Egypt</i>
<i>Germany, Federal Republic of</i>	<i>Iceland</i>	<i>Hungary</i>	<i>Japan</i>
<i>Greece</i>	<i>Israel</i>	<i>Poland</i>	<i>South Korea</i>
<i>Ireland</i>	<i>Liechtenstein</i>	<i>Romania</i>	<i>Mexico</i>
<i>Italy</i>	<i>Malta</i>	<i>USSR</i>	<i>Morocco</i>
<i>Luxembourg</i>	<i>Norway</i>	<i>Yugoslavia</i>	<i>New Zealand</i>
<i>Netherlands</i>	<i>Sweden</i>		<i>United States</i>
<i>Portugal</i>	<i>Switzerland</i>		
<i>Spain</i>	<i>Turkey</i>		
<i>United Kingdom</i>			
<i>European Economic Community (EEC)</i>			
<i>European Investment Bank (EIB)</i>			

<i>EXPANDED EBRD MEMBERSHIP</i>			
<i>Estonia (1992)</i>	<i>Kyrgyz Republic (1992)</i>	<i>Czech Republic (1993)</i>	<i>Jordan (2011)</i>
<i>Lithuania (1992)</i>	<i>Belarus (1992)</i>	<i>Slovak Republic (1993)</i>	<i>Tunisia (2011)</i>

2. Alice Amsden, "Beyond Shock Therapy: Why Eastern Europe's Recovery Starts in Washington," The American Prospect, December 19, 2001, <https://prospect.org/api/content/e5abe253-44fe-56ee-95b4-5a8a11106932/>.

3. Michael Orenstein, "155. Shock Therapy In Latin America, Russia, and Eastern Europe," Wilson Center, July 7, 2011, <https://www.wilsoncenter.org/publication/155-shock-therapy-latin-america-russia-and-eastern-europe>.

4. "Basic Documents of the EBRD," EBRD, September 30, 2013, [www.ebrd.com/news/publications/institutional-documents/basic-documents-of-the-ebrd.html%20](http://www.ebrd.com/news/publications/institutional-documents/basic-documents-of-the-ebrd.html%20).

EXPANDED EBRD MEMBERSHIP			
<i>Latvia (1992)</i>	<i>Kazakhstan (1992)</i>	<i>Croatia (1993)</i>	<i>Kosovo (2012)</i>
<i>Russian Federation (1992)</i>	<i>Georgia (1992)</i>	<i>North Macedonia (1993)</i>	<i>China (2016)</i>
<i>Ukraine (1992)</i>	<i>Azerbaijan (1992)</i>	<i>Bosnia &amp; Herzegovina (1996)</i>	<i>India (2018)</i>
<i>Uzbekistan (1992)</i>	<i>Tajikistan (1992)</i>	<i>Mongolia (2000)</i>	<i>San Marino (2019)</i>
<i>Moldova (1992)</i>	<i>Armenia (1992)</i>	<i>Serbia (2001)</i>	<i>Libya (2019)</i>
<i>Turkmenistan (1992)</i>	<i>Slovenia (1992)</i>	<i>Montenegro (2006)</i>	<i>Lebanon (2019)</i>

Source: “Where We Are,” EBRD, <https://www.ebrd.com/where-we-are.html>.

Perhaps the most distinguishing feature of the EBRD vis-à-vis other multilateral development banks (MDBs) was its mandated commitment to the key principles of democracy.<sup>5</sup> This commitment was codified in Article 1 of the Agreement Establishing the EBRD, which mandates that the financial institution carry out its functions only in those member countries that are “committed to and applying the principles of multiparty democracy, pluralism and market economics.”<sup>6</sup> EBRD shareholders recognized that economic reform did not take place in a political vacuum and that a serious reorganization of the post-Communist state apparatus required a pluralistic society and multiparty democracy. Shareholders believed that these principles and sociopolitical characteristics would ensure that the broader economic reform efforts did not lead to the transformation of state-owned monopolies into politically powerful private cartels. The charter also calls for the EBRD to not provide any concessional lending and to make a minimum of 60 percent of its commitments in the private sector.<sup>7</sup>

## *The Evolution of the EBRD*

Over its nearly 30-year history, the EBRD has made a total of €130 billion (approximately \$145 billion) in commitments (Figure 2). With globalization significantly impacting the political economy of Europe and its economic partners, the functions and operations of the EBRD started to evolve to better suit the interests of its member countries and shareholders. Moreover, a significant factor in the way the EBRD was understood and valued by the European community stemmed from a perception of the bank as a potentially useful instrument to support EU accession. This entailed a shift of geographic focus, sectors of investment, makeup of the clientele, and preferred financial instruments.

The EBRD has spread its regional focus significantly from the original 23 recipient countries and progressively expanded its reach into Mongolia (2006); Turkey (2009); Jordan, Tunisia, Morocco, Egypt, and Kosovo (2012); Cyprus (2014); Greece (2015); and Lebanon (2017). Over the years, countries in Central Asia and the Middle East and North Africa, have found a prominent place in the EBRD’s investment strategy. To illustrate this shift, about 62 percent of all new commitments made by the EBRD in 1993 were in CEE countries. A quarter-century later, only a third of new EBRD investments in 2018 were in those countries, while Southeastern Europe and the Middle East and North Africa received 18 percent and 21 percent, respectively. Cumulatively,

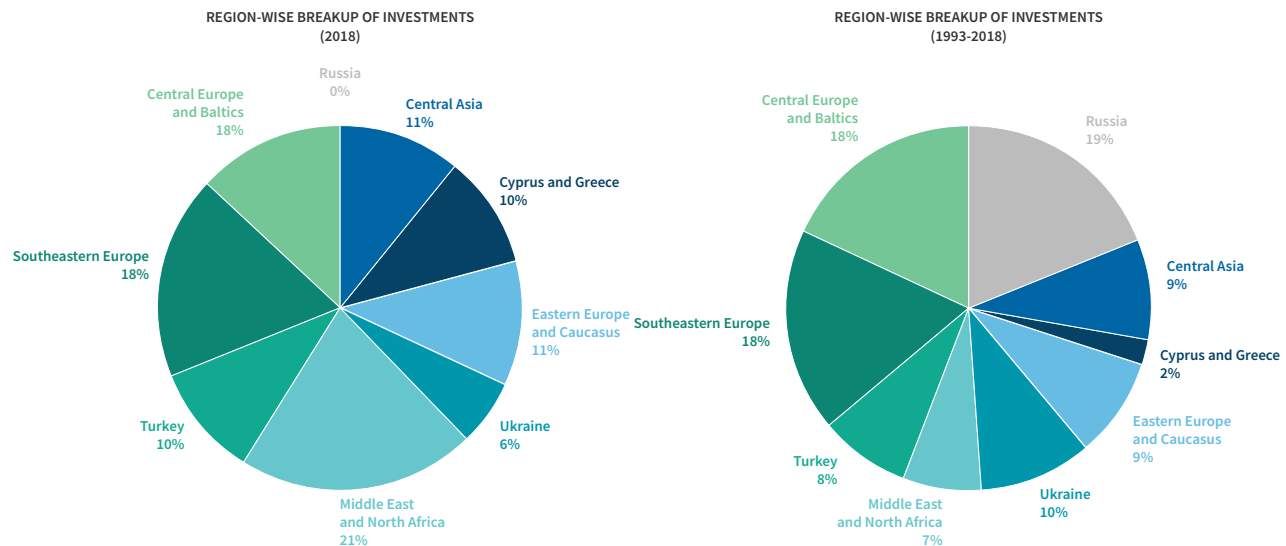
5. “Multiparty Democracy and Pluralism,” EBRD, [www.ebrd.com/our-values/multiparty-democracy-and-pluralism.html](http://www.ebrd.com/our-values/multiparty-democracy-and-pluralism.html).

6. “Basic Documents of the EBRD,” EBRD.

7. Ihsan Ugur Delikanli, Todor Dimitrov, and Roena Agolli, “Multilateral Development Banks: Governance and Finance,” in *Multilateral Development Banks*, 1st ed. (London: Palgrave Macmillan, 2018), p. 17, <https://www.palgrave.com/gp/book/9783319915234>; U.S. Congress, House, Committee on Banking, Finance, and Urban Affairs, Proposed U.S. Participation in the European Bank for Reconstruction and Development, and Update on Exchange Rate Report, Subcommittee on International Development, Finance, Trade, and Monetary Policy, 101st Congress, 2d sess., September 5, 1990, especially p. 39.

only about 37 percent of those commitments have gone toward the CEE countries, the Baltics, and the Caucasuses.<sup>8</sup> The initial impetus for the bank's expansion into North Africa was the Arab Spring; Libya was of particular importance as shareholders considered an expansion of the bank's geographic focus. Indeed, while Libya is tumultuous today, the EBRD would be ready to lead the reconstruction process when circumstances on the ground change positively.

Figure 2: The EBRD's Portfolio by Geographic Focus



Source: EBRD, *Annual Review 2018* (London: 2018), <https://www.ebrd.com/news/publications/annual-report/annual-review-2018.html>.

Russia has benefited the most from the establishment of the EBRD. In 1993, approximately 18 percent of the new commitments made by the EBRD were in Russia. Even though the country squandered the promise of a multiparty democracy with free market characteristics, and opted for authoritarianism and crony-capitalism, Russia was able to amass EBRD investments worth €24 billion (or \$27 billion) —nearly one-fifth of all the commitments made by the EBRD. By the late-2000s, shareholders were becoming increasingly wary of the growing authoritarianism in Russia and its failure to adhere to EBRD principles of democracy. But after the annexation of Crimea in 2014, the shareholders—led by the United States—were left with no option but to stop the EBRD from making any new investments in Russia.<sup>9</sup> Despite being the financial institution's largest lending market, Russia's dominance in the EBRD portfolio declined, with only €1.6 billion (or \$1.8 billion) which is 6 percent of all investments) active in the region. The EBRD has been consistent with its principles in other countries as well. Following the 2005 Andijon Massacre, the bank closed down all its activities in Uzbekistan.<sup>10</sup> Turkey—an upper-middle income country—has taken Russia's place. Since 2014, Turkey has been the single largest country for EBRD investments. And while Turkey received 11 percent of new EBRD investments in 2018, it lost its top recipient status to Egypt.<sup>11</sup>

8. Russia excluded.

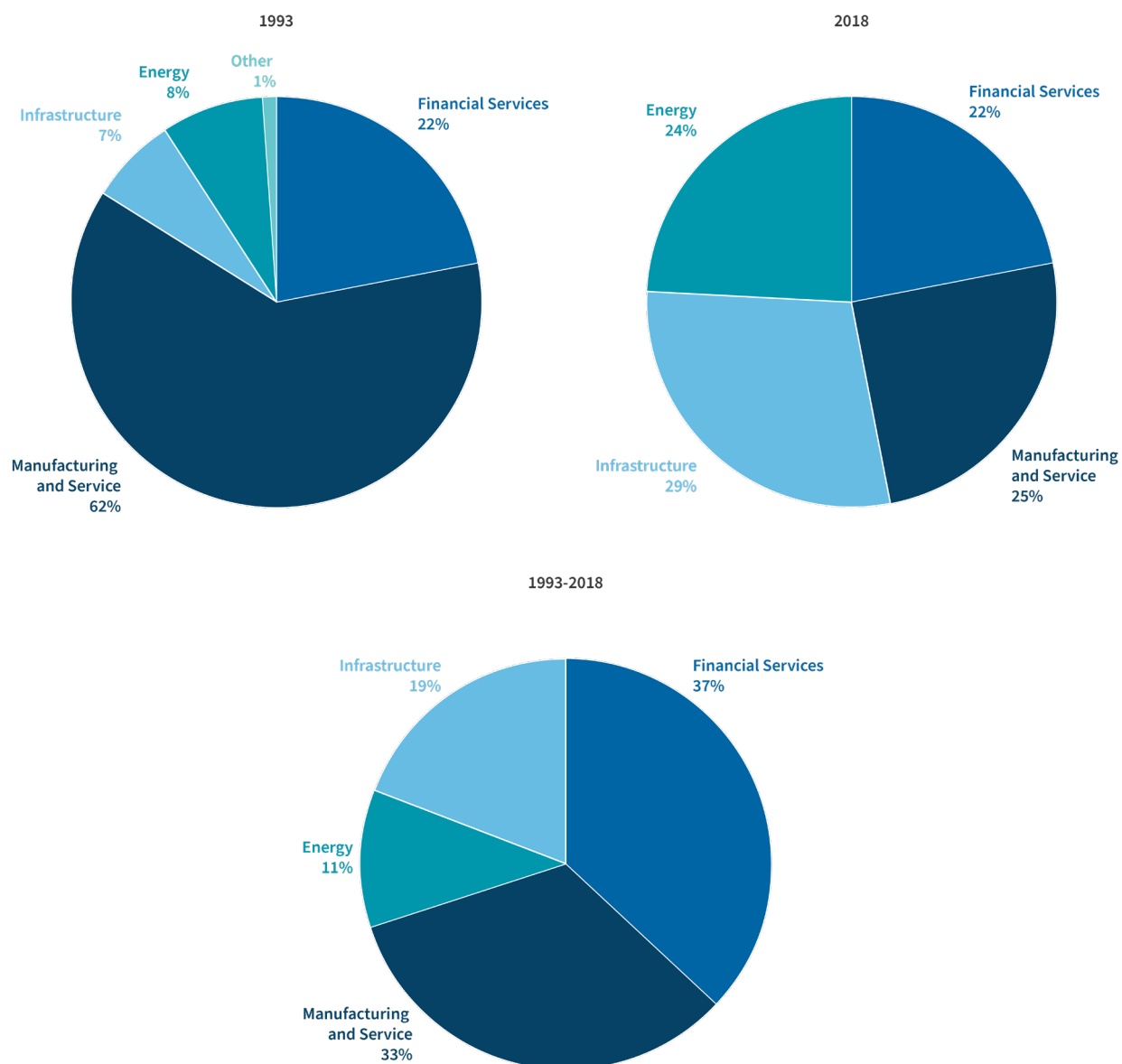
9. Jim Brunsden and Michael Peel, "Italy to Propose Ending Ban on EBRD Lending to Russia," *Financial Times*, June 28, 2018, <https://www.ft.com/content/f06d9b46-7afb-11e8-8e67-1e1a0846c475>.

10. Jeffrey Donovan, "Uzbekistan: UN, EU Call For International Probe Into Violence," *RadioFreeEurope/RadioLiberty*, May 19, 2005, <https://www.rferl.org/a/1058942.html>.

11. "EBRD Annual Review 2018," EBRD, May 8, 2019, [www.ebrd.com/news/publications/annual-report/annual-review-2018.html](https://www.ebrd.com/news/publications/annual-report/annual-review-2018.html).

Over the years, the EBRD has made investments in four critical sectors: energy, financial services, infrastructure, and manufacturing and services (Figure 3). Given its founding mandate, the EBRD originally had a disproportionately large focus on the manufacturing and services sector, committing over 62 percent of its portfolio there. As global economic players recognized the bottleneck created by the lack of a well-developed and modernized infrastructure, the EBRD (much like its multilateral counterparts) increased its commitments to infrastructure and the energy sector. Between 1993 and 2018, investments in the infrastructure sector increased from 7 to 29 percent, while energy sector investments grew from 8 to 24 percent.

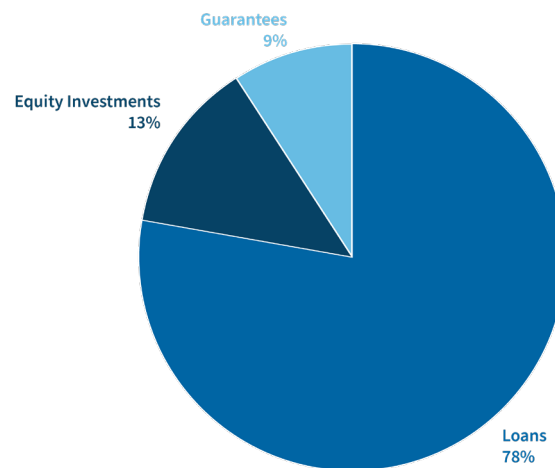
Figure 3: EBRD's Portfolio by Sector



Source: "Partner of Choice," EBRD, <https://www.ebrd.com/documents/portfolio/ebd-partner-of-choice.pdf?blobnocache>.

While the EBRD was originally founded as a development finance institution (DFI), it has recently added new forms of development instruments to its toolkits, including blended finance tools, sovereign finance instruments, research grants, and technical cooperation.<sup>12</sup> To realize its development objectives, the EBRD uses three principle direct financing instruments: debt, equity investments, and guarantees. To date, over three-fourths (approximately 78 percent) of its commitments have been in the form of loans. Meanwhile, just about 13 percent of its commitments were made in the form of equity investments, and less than a tenth (9 percent) of its commitments went into guarantees and other de-risking instruments.

Figure 4: EBRD Commitments by Instrument (1991-2018, Cumulative)



Source: “Project Finance,” EBRD, <https://www.ebrd.com/work-with-us/project-finance.html>.

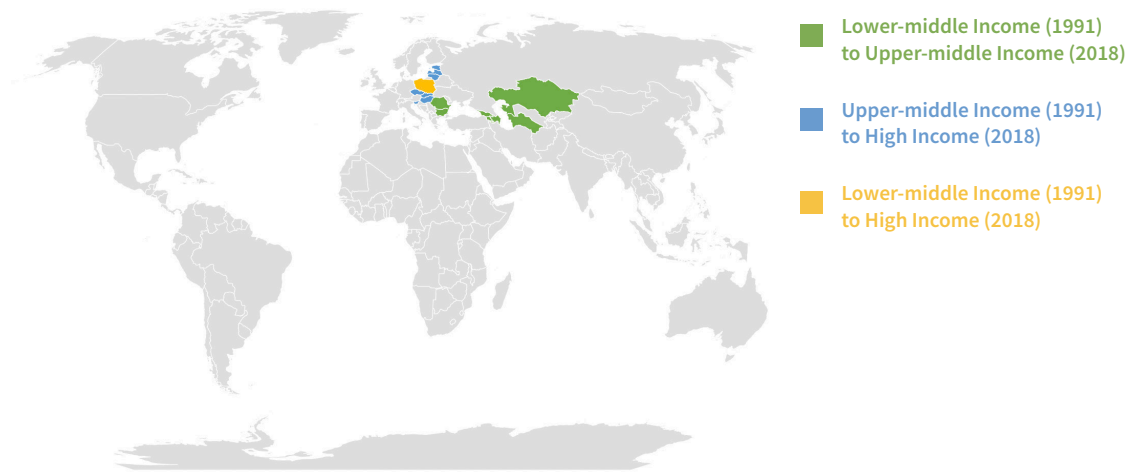
## *The EBRD’s Impact and Legacy*

With over €130 billion invested cumulatively in more than 5,000 individual projects, the EBRD has played a central role in transitioning many of the post-Communist countries toward a more stable state of political and economic affairs. It has also helped Europe become more interdependent, reducing the scope and opportunities for political and security crises across the continent. The human impact of EBRD activities are also significant. For instance, more than 2,090 projects, worth €51.6 billion, have been undertaken between 1991 and 2018 to support and strengthen financial institutions and capital markets. By 2016, the EBRD had supported over 400,000 micro, small, and medium enterprises through local currency loans, while its larger infrastructure initiatives have upgraded the quality of life for nearly 60 million people.

At a sovereign-level, member states have felt profound implications due to the EBRD and its activities. Of the 21 recipient countries who had joined the EBRD at its founding in 1991, 13 were classified as lower-middle income countries, while the other 8 countries were in the upper-middle income categories. Except Belarus, all the upper-middle income countries transitioned into the high-income category, while 8 of the lower-middle income countries have transitioned to the upper-middle income category. Only 6 original recipient countries have remained unchanged in their income classifications.

12. “Donor Funding Instruments,” EBRD, [www.ebrd.com/who-we-are/our-donors/donor-funding-instruments.html](http://www.ebrd.com/who-we-are/our-donors/donor-funding-instruments.html).

Figure 5: Change in Country Classification



Source: World Bank, “World Bank Country and Lending Groups,” Database, <https://datahelpdesk.worldbank.org/knowledgebase/articles/906519-world-bank-country-and-lending-groups>.

The EBRD’s foundational commitment to private-sector and free-market development had helped many of the post-Communist economies in transition rely on the financial institution for technical assistance and support as they pursued market reforms. These included the liberalization of prices, privatization of key economic sectors, establishment of functioning banking and credit systems, design of legal frameworks that honored contracts and property rights, and boosts to investor confidence overall.<sup>13</sup> As the EBRD helped drive market reform, countries such as the Czech Republic, Estonia, (formerly East) Germany, Latvia, Lithuania, and Poland made giant leaps and consolidated much of their reforms. Other countries, such as Croatia, Hungary, and Slovenia, made relatively slower, but steady, progress.<sup>14</sup>

To date, the Czech Republic is the only EBRD aid recipient that was deemed to have graduated from the EBRD, and it stopped receiving investments in 2008. By this time, the reform agenda had played out well in many of the post-Communist economies, which were enjoying the dividends paid by their investments in market institutions and free-enterprise systems. And even though the 2008 Global Financial Crisis rocked several European markets, the EBRD played an instrumental role in helping its member countries absorb the shocks and plan for the recovery.

## Challenges to Eurasian Prosperity

The fall of the Berlin Wall in 1989 ushered in a new era of optimism for the champions of liberal democracies. Thirty years later, the international community confronts new and complex challenges to realizing lasting peace and prosperity. Meanwhile, the resurgence of authoritarian regimes in China and Russia has resulted in a multipolar geopolitical landscape. In that context, both bilateral and multilateral global development partners need to evaluate their strategic priorities and sharpen their efforts in order

13. Claudia Irigoyen, “European Bank for Reconstruction and Development,” Centre for Public Impact (CPI) (blog), March 29, 2017, <https://www.centreforpublicimpact.org/case-study/european-bank-reconstruction-developnet/>.

14. Olen Havrylyshyn, Xiaofan Meng, and Marian L. Tupy, “25 Years of Reforms in Ex-Communist Countries: Fast and Extensive Reforms Led to Higher Growth and More Political Freedom,” Cato Institute, July 12, 2016, <https://www.cato.org/publications/policy-analysis/25-years-reforms-ex-communist-countries-fast-extensive-reforms-led>.



to be relevant and impactful. In the case of the EBRD, the following challenges need to be accounted for as the financial institution's future directions are determined.

## **I. THE RUSSIA CHALLENGE IN EURASIA**

The 2014 Russian invasion into Ukraine, which led to the annexation of Crimea, revealed the extent to which an authoritarian Russia was willing to undermine the sovereignty and security of the transatlantic community and a U.S. ally. In recent years, Russia has also stepped up its efforts to undermine the democratic and free-market institutions among European countries—many of which are members of NATO—by sowing social, economic, and political tensions.<sup>15</sup> This rise of illiberalism and Russian aggression poses new challenges for the United States, the European Union, and multilateral institutions, such as NATO and the EBRD, which together must organize for a coherent and sharp response.

At the same time, there are broader energy independence and security considerations. For decades, the transatlantic community has stood in solidarity and successfully blocked the spread of communism. In order for the community to sustain its efforts to block authoritarian actors (new and old), it is vital that the European Union achieve energy security and end dependence on markets such as Russia.<sup>16</sup> This, however, is not happening, as Europe is taking steps that will make it more, not less, dependent on Russian energy, such as the building of the Nord Stream II pipeline. According to a 2018 report, the European Union imports about 25 percent of its natural gas from Russia. That is a substantial portion, with some EU members having greater dependence on Russian natural gas than others.<sup>17</sup> Germany, for instance, imports 35 percent of its gas from Russia.<sup>18</sup> Although this trend has been going on for decades and has made significant financial contributions to Russia, it does point to a weakness in the transatlantic community's ability to counter Russia in an era of strategic competition.

Ensuring that the European Union is energy secure and energy independent is a key priority for the United States. Fortunately, there are a number of alternatives to Russian energy sources, primarily in the Mediterranean, the Caspian Sea, and the Western Balkans.<sup>19</sup> And while it is necessary to address the threats to sustainable development posed by extreme weather conditions and climate destabilization, energy policies cannot ignore the threat posed to the transatlantic community by energy dependence on Russia. Rather, the European Union must reconcile its efforts such that both risks—security and independence—are addressed in tandem.

## **II. THE CHINA CHALLENGE IN EURASIA**

For a range of reasons, Central Asia is important to the United States and its allies in Asia and Europe. Central Asian markets have enormous potential in sectors such as agrobusiness, financial services, education, energy, tourism, and natural resource management that, with strategic investments, can

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15. Heather A. Conley et al., *The Kremlin Playbook* (Washington, DC: CSIS, October 2016), <https://www.csis.org/analysis/kremlin-playbook>.

16. Becca Hunziker, "The Current State of European Energy Security and Transatlantic Cooperation," Atlantic Council (blog), June 27, 2019, <https://www.atlanticcouncil.org/commentary/energysource-explains-european-energy-security-and-transatlantic-cooperation-a-current-assessment/>.

17. Ivana Kottasová, "Europe Is Still Addicted to Russian Gas," CNN Business, June 5, 2018, <https://money.cnn.com/2018/06/05/news/economy/russia-europe-gas-dependency/index.html>.

18. Dave Keating, "How Dependent Is Germany On Russian Gas?," Forbes, July 19, 2018, <https://www.forbes.com/sites/davekeating/2018/07/19/how-dependent-is-germany-on-russian-gas/#4eb7356f3b48>

19. Gordon Sondland, "Reliance on Russian Gas Has Big Risks for Europe," Financial Times, March 12, 2019, <https://www.ft.com/content/4cfd4b1e-43eb-11e9-b83b-0c525dad548f>

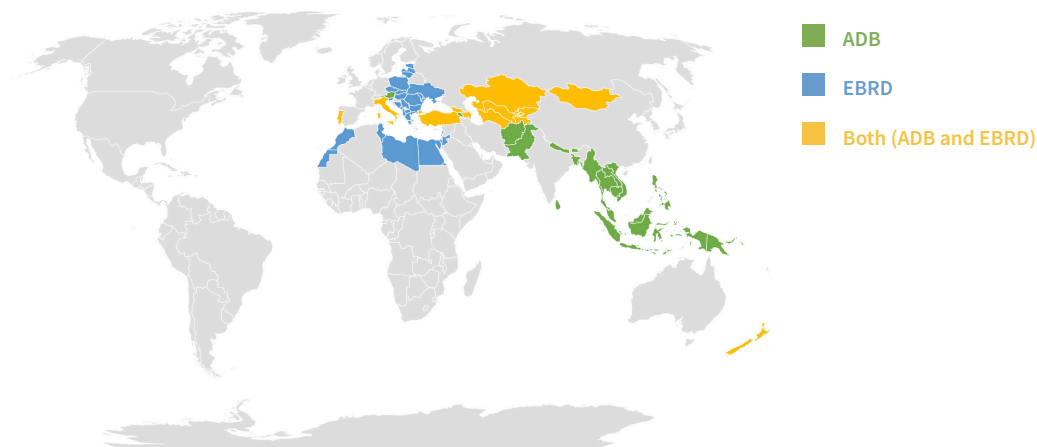


be developed and harnessed. Despite various attempts, it is one of the least-connected regions in the world. Geographically, Central Asia is tucked between China and Russia, and an alternative can only emerge if the region is linked to European and South Asian countries. By securing infrastructure connectivity, new markets can be created that will yield long-term dividends to the regional—and global—economies.

In 2013, China launched its ambitious Belt and Road Initiative (BRI), which seeks to connect Asia and Europe. Announced in 2013, the BRI now includes 43 countries and approximately 70 percent of the global population and is estimated to cost as much as \$8 trillion.<sup>20</sup> With \$4 trillion in unmet infrastructure investments annually, such an initiative is worth both our attention and investment, as the international community needs all the help it can get to close this gap.

However, the Chinese model of financing infrastructure is concerning because it jeopardizes focus on quality infrastructure. Though it launched its own development bank—the Asian Infrastructure Investment Bank (AIIB)—and helped set up the New Development Bank (NDB) to help finance this important initiative, China has caused alarm among other donor countries with the Hambantota Port episode in Sri Lanka and the Railway Investment and Debt scandal with Kenya.<sup>21</sup> These two high-profile episodes, among others, have created an opening for multilateral development banks—most of which are spearheaded by the United States and its allies—to lead the dialogue and to facilitate high-quality investments into infrastructure projects globally. Here, the EBRD has a direct interest in assuming a larger role, as more than half the countries (22) under the BRI receive financing from the EBRD.<sup>22</sup>

Figure 6: BRI Countries Covered by the ADB and EBRD



Source: Countries identified by CSIS using public data available on [www.adb.org](http://www.adb.org) and [www.ebrd.com](http://www.ebrd.com)

20. Iain Marlow, “Backlash Could Cost Xi Jinping’s Belt and Road \$800 Billion, Report Says,” *Economic Times of India*, September 13, 2019, <https://economictimes.indiatimes.com/news/international/business/backlash-could-cost-xi-jinpings-belt-and-road-800-billion-report-says/articleshow/71102781.cms>; Daniel F. Runde and Aaron Milner, “The Role of U.S. Soft-Infrastructure in Influencing the Reconnecting of Asia,” CSIS, Commentary, November 16, 2016, <https://www.csis.org/analysis/role-us-soft-infrastructure-influencing-reconnecting-asia>.

21. Daniel F. Runde, Erol Yayboke, and Sundar R. Ramanujam, “Achieving Sustainability through Quality Infrastructure,” CSIS, CSIS Brief, June 21, 2019, <https://www.csis.org/analysis/achieving-sustainability-through-quality-infrastructure>.

22. Runde and Milner, “The Role of U.S. Soft-Infrastructure in Influencing the Reconnecting of Asia.”

The extent of Chinese involvement in Central Asia is astounding. In 2019, China had committed \$304 billion in investments to the region, whereas the EBRD had only invested \$12 billion, roughly 4 percent of the Chinese figure.<sup>23</sup> China's substantial investments in projects expanding regional connectivity have broader geopolitical implications for the United States and its allies. There is a growing concern that the absence of Western leadership in the region has paved the way for China and Russia to increasingly influence Central Asia's economic and security activities.<sup>24</sup>

### III. LACK OF A CLEAR STRATEGY AND SHAREHOLDER CONSENSUS

Despite many recipient countries making significant strides and realizing substantial gains, such as Poland and Hungary (both high-income countries), the EBRD has only graduated one of its recipients in its history. Meanwhile, upper-middle income countries like Turkey have become some of the largest recipients of concessional financing, furthering the conviction that the EBRD needs to sharpen its efforts. The EBRD currently lacks a focused graduation policy. It has also not been innovative with the products it can offer to countries that meet the graduation requirements. These factors have left the financial institution with a less efficient business model and made it less impactful in its development objective.

More importantly, there is a lack of consensus among member states on the future and relevance of the EBRD. This is a real cause for concern and risks creating fault lines within the EBRD architecture that members (and non-members) can exploit for malign objectives. In particular, the report from the High-Level Group of Wise Persons to the European Union has caught the attention of U.S. policy-makers.<sup>25</sup> Submitted in October 2019, the report posits the following three potential paths to secure increased development finance capabilities for the European Union, all of which have direct implications for the EBRD.

- i. Become the European Climate and Sustainable Development Bank and absorb the external financing portfolio of the European Investment Bank (EIB).
- ii. Create an independent European Climate and Sustainable Development Bank that is constituted by the EIB, the European Union, the EBRD, member states of the EBRD, and other development finance stakeholders.
- iii. Create the European Climate and Sustainable Development Bank as a subsidiary of the EIB.

None of these three recommendations are easy to operationalize or void of any political hurdles. They are also conspicuously silent about the critical role of the private sector. The second recommendation is bound to further complicate the existing development finance architecture of Europe, which the High-Level Group of Wise Persons meant to simplify. Meanwhile, the last option requires a wholesale redesign of the EIB, which has neither the capacity nor the operational culture to undertake the level of development activities that the shareholders envision. But perhaps the most difficult of these recommendations is the first one, because it would require the shareholder structure to change such

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23. EBRD, *The EBRD in Central Asia* (London: November 22, 2018), <https://www.ebrd.com/news/publications/brochures/the-ebrd-in-central-asia.html>; "Why Central Asia Chooses Chinese Investment," East Asia Forum (blog), June 29, 2019, <https://www.eastasiaforum.org/2019/06/29/why-central-asia-chooses-chinese-investment>.

24. Paul Wasserman and Mollie Saltskog, "Sino - Russian Alignment in Reality: The Case of Central Asia," Global Risk Insights, March 6, 2019, <https://globalriskinsights.com/2019/03/china-russian-central-asia/>.

25. Thomas Wieser et al., "Europe in the World: The Future of the European Financial Architecture for Development" (Brussels, Belgium: Council of the European Union, October 2019), [https://www.consilium.europa.eu/media/40967/efad-report\\_final.pdf](https://www.consilium.europa.eu/media/40967/efad-report_final.pdf).

that the European Union would hold a strong majority of shares.<sup>26</sup> Theoretically, it would also require the EBRD to abandon its original mission of establishing sustainable free-market economies in the European community and other member countries—a job that, by any measure, is unfinished—and enter sub-Saharan Africa. Any modification of the articles of agreement will also need the support of 85 percent of the shareholders, with no member having a veto.<sup>27</sup> While the EBRD certainly needs to undergo a strategic reorientation, it is unclear if implementing the report’s recommendation in letter and in spirit is the appropriate way forward.<sup>28</sup>

#### **WHY IS THE EBRD IMPORTANT FOR THE UNITED STATES?**

As this report makes clear, the United States has strategic and security interests in the EBRD and its activities. First, the soft power development finance capabilities of the institution are expected to serve as a force multiplier in Central Asia (in the context of the BRI and the China challenge) and Ukraine (in the context of the Russia challenge). Second, it is one of the leading institutions that has successfully fostered private sector-led development around the world. Sustaining these functions will be critical for the United States as it looks for new commercial markets and trading partners. Third, the economic and political development of the Maghreb region, which currently receives over one-fifth of the EBRD’s investments, has long-term geostrategic implications for the United States. Finally, with significant investments being made into activities in Jordan and Turkey—two of the largest recipients of Syrian refugees—the bank is playing a lead role in mitigating the risk of radicalization within the refugee camps and helping the United States counter violent extremism.

### *The Next 30 Years of the EBRD: The Path Forward*

Today, the challenges confronting the transatlantic community—and the world—are more complex and multidimensional than at the end of the Cold War. As Russia, with its malignant strategic objectives, grows in influence, there is a divide within the European community on how security concerns need to be balanced with the realities of commercial interdependence. There is also expansion fatigue among members of both NATO and EU institutions. Meanwhile, there are concerns about overgrown EU institutions in the United States, with policymakers concerned about the mechanics involved in implementing some of the Wise Persons’ Group’s recommendations and its effects on U.S. equities.

As shareholders consider the benefits and costs of implementing any of the three strategies presented by the Wise Persons’ Group, CSIS submits the following five recommendations for the consideration of shareholders. These recommendations reflect upon the original purpose of the EBRD, account for the challenges of the twenty-first century, and prioritize the delivery of an efficient and impactful development strategy for the financial institution.

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26. Mikaela Gavass, “The Wise Persons Group Report on Europe’s Development Finance Architecture: Merger, Acquisition, or Reinvention?” Center For Global Development, October 21, 2019, <https://www.cgdev.org/blog/wise-persons-group-report-europes-development-finance-architecture>.

27. Delikanli, Dimitrov, and Agolli, “Multilateral Development Banks,” p.17.

28. Wieser et al., “Europe in the World.”

**RECOMMENDATION 1: RETURN THE EBRD TO PRIVATE-SECTOR DEVELOPMENT, ITS ORIGINAL MANDATE AS A DEVELOPMENT FINANCE INSTITUTION.**

Over the years, the EBRD has drifted away from its founding mandate of investing in political and economic reforms and market institutions that can enable private-sector development. As EBRD stakeholders consider its future role and relevance, it is important to pivot back to the original mission.

Sustainability in economic development cannot occur without countries tapping into the hundreds of billions of dollars available in local pension funds, local national savings, and other pools of capital. Still, emerging market economies in Eastern Europe, as well as Central and South Asia, have sectors that are unable to turn these pools of capital into viable investments essential for job creation, middle-class expansion, and economic development. Many countries in Asia need technical assistance from development agencies to help deepen and develop local capital markets. Given its track record, the EBRD is in a unique position to continue its core functions and operations in such country contexts. It can also make innovative uses of underutilized development finance instruments, such as guarantees and other risk-sharing instruments, to help mobilize private capital.<sup>29</sup>

In addition to helping emerging markets mobilize private capital, the EBRD is also instrumental for low-income countries in the Maghreb that struggle with fragility and weak institutional capacity. With many in a protracted state of conflict between warring ethnic and social groups, there is a lack of public trust in political and market institutions—a pre-requisite for capacity building—reinforcing existing challenges to private-sector development. Using a range of concessional financing tools, the EBRD can champion certain pioneer firms. These firms, if successful, can create investment clusters in frontier markets and break the vicious cycle of underdevelopment and weak state capacity.

**RECOMMENDATION 2: STAY IN YOUR LANE AND FINISH THE JOB.**

There has been a steady push for the EBRD's portfolio to become a more climate de-risking financial institution with a predominant focus on sub-Saharan Africa. The European Union—whose members control 62 percent of the EBRD—has become the most prominent advocate for this shift, particularly through the October 2019 Wise Persons' Group report.<sup>30</sup>

Such a shift would be a strategic mistake for the EBRD, as it would require the EBRD to abandon its original mandate of securing economic and political reforms to enable the growth of free enterprise. Today, a number of the EBRD's member countries—particularly the low-income and lower-middle income countries in the Caucasus, the Balkans, the Maghreb, and Central and South Asia—stand to benefit from its core operations of providing concessional finance and technical assistance. These services help the countries attract private investments for the energy sector, infrastructure projects, communications, and other sustainable industry development enterprises. Further, the EBRD should lead the global effort to secure connectivity for the Europe-Central Asia-South Asia corridor. With new donors flooding the market with cheap finance that often comes with strategic and geopolitical consequences, it is vital that institutions like the EBRD offer an alternative to such sources of capital. It can provide an option that achieves the commercial objectives while preserving principles of transparency, accountability, and sustainability.

Additionally, while climate de-risking is critical to ensure resiliency and sustainability, the EBRD should simultaneously ensure that its efforts to combat climate destabilization do not compete with

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29. Romina Bandura and Sundar R. Ramanujam, *Innovations in Guarantees for Development* (Washington, DC: CSIS, October 2019), <https://www.csis.org/analysis/innovations-guarantees-development>.

30. Wieser et al., "Europe in the World."

its efforts to secure Europe's energy independence. Until viable alternatives are available, the EBRD should focus on developing the natural gas sector, make targeted investments where necessary in reliable energy sources, such as fracking and even coal in Kosovo, and safeguard the strategic interests of European countries and the wider transatlantic community. The EBRD should revisit expanding its footprint in 5 to 10 years.

**RECOMMENDATION 3: DEVISE A CLEAR GRADUATION AND POST-GRADUATION POLICY.**

In its 28 years of history, the EBRD has graduated only one country: the Czech Republic. Of the 39 recipient countries, 10 are high-income countries, while 18 are upper-middle income countries. Despite many of these countries having access to international capital markets, the EBRD continues to provide them with subsidized funding. Not only does this distort the global economic landscape, it hinders the EBRD from having a sharper focus and realizing greater development impacts.

The EBRD must move toward a fast-track system to graduate many of these high-income and upper-middle income countries. The capital that is released as a result should be reallocated toward targeted sub-national lending in lower-middle income countries and lending for fragile states, which are often low-income countries saddled with high rates of poverty which struggle to build institutional capacity for basic state and market functions.

The graduation of countries will certainly reduce the overall revenue inflows for the EBRD, and the financial institution should be prepared for that. However, this revenue drop can be offset if the EBRD considers engagement with these countries through a menu of non-financial advisory and technical services for a fee. Additionally, the EBRD can move away from loans and grants for these countries and instead explore other options, such as using guarantees and other risk-sharing instruments. The financial institution can also consider making equity investments in projects in the infrastructure and energy sector that promise long-term revenue flows.<sup>31</sup>

**RECOMMENDATION 4: PRESERVE U.S. LEADERSHIP.**

At the peak of World War II, the United States developed deep and strong relationships with European countries, both bilaterally and as members of the transatlantic community. This relationship witnessed the collapse of authoritarian regimes fueled by destructive ideologies—twice. With authoritarianism on the rise once again, in the form of China and Russia, the world is entering another era of strategic competition. The preservation of a U.S. led international order—which has been a source of strength during the Cold War—is of paramount significance if liberal democratic forces want to contain the influence of these authoritarian actors. As the largest shareholder of the EBRD, the United States controls just over 10 percent of the votes in the system. Western European countries account for about 35 percent of the shares, and Japan holds 9 percent.

In recent years, there has been informal talks in Washington of selling off U.S. shares in the EBRD. These comments by unauthorized members of the Trump administration in semi-public fora are well known in Europe and were a catalyst for some of the options in the Wise Persons' Group report. Such loose talk has been very unhelpful for U.S. interests. There were also some rumblings about selling U.S. shares at the end of the Bush administration. This must stop, as it is not U.S. policy to sell the shares in the EBRD, and such a policy would find significant bipartisan resistance on Capitol Hill.

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31. Daniel F Runde, Conor M. Savoy, and Romina Bandura, "Creating a Twenty-First-Century Business Model for the EBRD," CSIS, March 2018, [https://csis-prod.s3.amazonaws.com/s3fs-public/publication/180307\\_Runde\\_CreatingModelEBRD\\_Web.pdf](https://csis-prod.s3.amazonaws.com/s3fs-public/publication/180307_Runde_CreatingModelEBRD_Web.pdf).

Such a move would be politically very difficult, would likely result in a very limited financial return for the United States, and would result in a catastrophic loss of influence for the United States in a region where Russia and China are increasing theirs, giving the appearance of the United States ceding influence in the region to competitors. The so-called sale of U.S. shares would likely merely yield the share value of the United States, which would be €139 million (\$155 billion).<sup>32</sup> It would likely forfeit the much larger accumulated profits associated with its leadership for the past several decades, making a voluntary exit a very bad financial deal and a catastrophic foreign policy blunder. However, the more concerning report is that the EU members may—in order to facilitate the implementation of the Wise Persons’ Group recommendations—increase their capital contributions. This would effectively limit the influence of non-EU members, including the United States.

Diminishing the U.S. role in the EBRD in any form will chip away at that international order. The U.S. Departments of State and Treasury should lead engagements with their European counterparts and build consensus among its closest partners (including Australia, Canada, Japan, France, Germany, Italy, Spain, the United Kingdom, and other EU members) on a new strategic direction for the EBRD and clarify that the United States is not selling U.S. shares or allowing its voting power to be diluted.

#### **RECOMMENDATION 5: CHANGE DEAL INCENTIVES.**

Finally, the EBRD management needs to be incentivized to shift its investment culture. Like other major multilateral development banks, the EBRD also suffers from the “volume culture.” This means that the staff and officials driving the operations are incentivized to pursue large-volume deals. As countries graduate, the EBRD will be forced to go into geographies that are more difficult to invest in or that have a small pipeline of bankable projects. A change in the business model, together with internal management reforms, can facilitate a shift away from this volume culture. This can include changes like pursuing a performance appraisal policy that prioritizes metrics such as quantity of deals or per dollar private capital mobilization of a deal over the volume of the debt/loan deal that is closed. Other measures that are slightly more complex involve adopting new frameworks that examine the micro-level development impact on a community level, as well as the implications of a development project over a recipient country’s ability to realize long-term sustainable development. Additionally, officials can leverage some of its underutilized blended finance tools to help countries develop a pipeline of bankable projects—particularly in the infrastructure sector—and open up new avenues to attract private investments.

#### **RECOMMENDATION 6: CHOOSE A NEW PRESIDENT WHO IS ON BOARD WITH THIS AGENDA.**

Ronald Reagan said that personnel is policy. The EBRD shareholders need to pick a new president who is on board with finishing the job in the current footprint of countries, leery of Russian influence, pro-U.S. interests, and open to the suggested reforms described in this report. Sir Suma Chakrabarti has been an excellent leader of the EBRD, and the next president needs to be someone who can build on Sir Suma’s legacy.

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32. “USA: EBRD Shareholder Profile,” EBRD, [www.ebrd.com/pages/about/workwith/donors/countries/usa.shtml](http://www.ebrd.com/pages/about/workwith/donors/countries/usa.shtml).



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*This report is made possible by general support to CSIS. No direct sponsorship contributed to this report.*

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