Program for the Study of Germany and Europe
Working Paper Series #2.2

Origins of the European Bank for Reconstruction and Development

by Steve Weber*
Department of Political Science
University of California, Berkeley

Abstract

In post-Cold War Europe, the persistence of old international institutions and the development of new ones provide a testing ground for theoretical debates about the sources and consequences of international institutions. This paper examines the origins of the European Bank for Reconstruction and Development (EBRD), a new institution created in 1990 with the self-proclaimed mission to foster the transition in Central and Eastern Europe toward states with market economies and democratic political systems. The EBRD is neither a product of concentrated power nor a perpetuation of extant international regimes, but is instead the product of convergence on a broad set of ideas and purposes shared among an intermediate-sized group of powerful nations. Negotiating the EBRD spawned a reexamination of interests among the major states that drove closer together their conceptions of interest with regard to the challenges they faced in Eastern Europe. The EBRD is developing a role in Eastern Europe different from that played by other multilateral development banks and, importantly, different from that which would be played by individual states were they to seek mainly to advance their self-interest, as defined within the stark geopolitics of neorealism, in an important part of the world. Whether cooperation can be sustained by this foundation is a critical question for theoretical arguments about international institutions and the outcomes they promote, then it is possible that shared ideas and the institutions connected to them could prove robust, even within an international system characterized by a diffuse distribution of power. The early history of the EBRD provides some support for that argument.

---

*This paper is written solely in the writer's capacity as assistant professor of political science at Berkeley. The opinions contained in this paper are his own; none reflect an official statement of the policy or position of the European Bank for Reconstruction and Development. The author currently serves as Council on Foreign Relations International Affairs Fellow at the European Bank for Reconstruction and Development.

I received an enormous amount of help in writing this paper, from individuals in both the policy and the academic communities. I thank in particular the many officials who granted me interviews and who I refer to within the paper. In most cases, these interviews were granted on the condition of confidentiality, and I provide only the institutional affiliation of the source. I owe a great debt to David Stuligross, Eileen Doherty, and Stephanie Gluckman, for research assistance and critical comments. Ernst Haas, John Zysman, Philip Goldman, Molly O'Neal, Jason McDonald, Nicholas Ziegler, Andrew Moravscik, and Raymond Vernon read earlier drafts and provided extremely helpful suggestions. I presented bits and pieces of this research at various forums at Berkeley, at the University of Washington, at Princeton University, and at the Harvard Center for European Studies, and I owe a particular debt to the piercing questions that seminar participants offered. Felicia Wong, as she always does, pushed me to think more clearly about what it was I really wanted to say.

What role might international institutions play in the transformation of an international system? The stark neo-realist answer to this question depends on the character of the system, not on the institutions. Logically, a "multipolar" system presents more opportunities and incentives for disagreement and for conflict than do "hegemonic" systems. As power diffuses among a number of states, cooperation will tend to fall victim to dilemmas of collective action and ultimately to a lack of shared interests. Institutions, which reflect closely the self-interest of powerful states and the distribution of power among them, do not modify substantially this logical picture. International institutions are set up by a hegemonic state to further its own economic and security interests and they deteriorate as power disperses. This might have changed the nature of international politics in Europe over the last two decades, had the impact of America's declining overall power position not been allayed by the Soviet threat and continuing US predominance in military capability. But with the Soviet threat dissipating or perhaps gone, military power no longer substitutes for the broader resources that are needed to keep stable an international system. Underlying trends should now come to the fore -- driving states' interests in different directions and undermining the prospects for continuing high levels of cooperation.[1]

The point put simply is that in neo-realist theory and its variants, the move toward institutions is associated with <u>concentration</u> of power, not its diffusion. When power dissipates, institutions are supposed to decline.[2] But in Europe today, the institutions associated with a previous hegemony, not wiped away by war as they generally have been in previous transitions between international systems, remain on the scene and in some cases appear, at least, to be strengthened. At the same time, new institutions are being created in Europe by new actors who are not predominant in the traditional resources of power.

The European Bank for Reconstruction and Development (EBRD) may be the most visible example. On 29 May 1990, 40 states and two European organizations signed in Paris Articles of Agreement to establish this new institution with the declared purpose "to foster the transition towards open market-oriented economies and to promote private and entreprenaurial initiative in the Central and Eastern European countries committed to and applying the principles of multiparty democracy, pluralism, and market economies."[3] This is an ambitious charge, but the EBRD is more than a bland international secretariat armed with grand language and resources in inverse proportion. It is in some ways a unique institution with remarkable new features that is in the process of defining a realistic operational domain. Although the Bank is one of many (and certainly not the most important) external actor in the economic and political environment facing Central and Eastern Europe (CEE), it is well positioned to play a significant role in the future of the region. I argue in this paper that the EBRD is developing a role different than from that of other international financial institutions (IFIs) in CEE and different from that played by other multilateral regional development banks in their own areas of operation. I argue also that it is different from that which would be played by individual states were they to seek mainly to advance their self-interest, as defined within the stark geo-politics of neo-realism, in an important part of the world.

This raises two central questions. The first is, how and why was this new institution created? I argue here that the EBRD is neither a product of concentrated power nor a perpetuation of extant international regimes.[4] Rather, the EBRD is the product of convergence on a broad set of ideas and purposes shared among an intermediate size group of powerful states. The stress my argument places on ideas as a source of international institutions is itself not outstanding. Ideas matter, and the ideas of the powerful matter more. What is different is that this institution is not driven principally by the ideas of a single predominant state, and cooperation in this case does not amount to a previously-defined collective good now being

provided by committee. Instead, the process of creating an international institution to deal with a new problem spawned a re-examination of interests among the major states that drove their conceptions of interest with regard to that problem closer together. Put differently, negotiating the EBRD produced a convergence not a divergence of interests despite the different geo-political positions of the major actors vis-a-vis CEE and the lack of any hegemonic power. The May 1990 Agreement is the concrete manifestation.

The second question is can cooperation be sustained by this foundation? Theoretical arguments and historical precedents give pause, and current data -- even if it appears anomalous -- needs to be taken with care since the process of transition in Europe has really just begun. I discuss the reasons for pessimism and recognize that it is far too early to dismiss them. At the same time, I try to shift discussion to the realm of the possible. Instead of stressing states and their interests conceived classically through the lens of power, my argument focuses on ideas and on international institutions as a possible source of convergent interests. For the moment, these institutions appear to be playing an important role in the calculations of states. This may be just a lag in history, anticipating the moment when institutions fail or are submerged in predicted patterns of multipolar international politics, or it may not be. The evidence to distinguish finally between these outcomes may not become clear for some time to come.

In the meantime, the second question can be usefully recast to ask, will the convergence among conceptions of interests that I demonstrate in the process of creating an institution be reinforced by what that institution does as it carries out its operations, or will it be undermined? If institutions prompt states to view or re-define interests in compatible ways and these conceptions of interest are in turn reinforced by the institutions and the outcomes they promote, then it is possible that shared ideas and the institutions connected to them could prove robust, even in a

multipolar international system. Nobody knows to what extent the EBRD will "succeed" in its mission, but that is not the only important question for its Western members. More significant for my argument here is whether what happens within the institution and in its operations will reinforce the convergence of interests among those states that was its birthright. It is important to remember that the simple initiation of a new international institution during a period of transition does not qualify as a basis for a hard knock against realism's anti-institutional bias.[5] But the specific circumstances of the EBRD's founding, the broader context in which it happened, and the content of the ideas that make up its foundation make the possibility worth serious inquiry.

II. The Origins of International Institutions

International institutions need to be explained, not assumed.[6] Sovereign states may define in incompatible ways issues on the international agenda and propose different "solutions" that make little sense from other states' perspectives. Even when states agree on the general definition of an issue there typically are many options for acting on it with different implications for who pays and who benefits. The question about institutions is not only why do they exist but why does one institution and not another come into being, when an excess of alternatives exists? In 1989, the Western allies agreed broadly about the nature of the problem they were facing in the CEE economies and about the downside risks should attempts to rescue the economies of these countries fail. But as I argue later in the paper, this "problem" -- in its shared general definition -- did not define either a single solution or an institutional form through which solutions could be pursued. States offered different plans of action. Each separate strategy could have been matched with a particular institutional arrangement, many of which were equally feasible to EBRD.

There also could have been no agreement, in which case states would have gone their own individual ways without the benefit of coordination or cooperation within an international institution.

These represent two null hypotheses: EBRD as a functional solution to a defined problem that determines uniquely or optimally the institutional form through which a solution is to be sought; or EBRD as a cosmetic overlay to states' unilateral purposes and strategies, an institutional facade for an agreement to disagree. Neither hypothesis looks right at present. EBRD was conceived as a distinctive international institution with specificity of form and purpose different from that of other IFIs. First, the Bank is self-consciously a political institution, with the explicit purpose to facilitate development of a certain kind of state and economy in CEE. This reverses specifically the commitment of other IFIs to exclude political purposes from their programs.[7] EBRD is also self consciously a European institution, with the 12 European Community (EC) members plus the Community itself and the European Investment Bank (EIB) holding a majority of the shares. With 10 billion ecu pledged capitalization, EBRD was at its birth in 1990 only about 1/14th the size of the World Bank , but it was set up to operate in a small region made up of just 6 countries comprising 2.5 percent of world population and accounting for only 2 percent and 4 percent of world production and trade, respectively.[8] In working with its recipient countries, the EBRD will have the advantage of new operating methods and a package of finance instruments unique among IFIs. The EBRD can make loans and take equity positions in private enterprises, as well as engage in diverse kinds of funding opportunities consistent with its overall purposes, to facilitate the growth of private enterprise and market economies in the former socialist countries. That priority is operationalized uniquely, in the combination of development and merchant banking through the so-called 60/40 provision. With various conditions, not more than 40% of the bank's operations can aid the state sector; the remaining 60% must be directed to private or

privatizing enterprises without guarantees from the state.[9] The EBRD, then, is a new institution with a combination of features that make it unique among IFIs and perhaps among international institutions generally.

How did this particular institution come about? Theories of international relations generally have more to say about what international institutions do than about their origins, but it still is possible to extract a few useful hypotheses.[10] Neo-realism and particularly its subsidiary hegemonic stability theory suggest that institutions are created by a dominant state to promote its own interests; refined versions of the theory incorporate ideas, "milieu goals", and domestic politics into the hegemon's conceptions of interest but still focus on the role of the powerful state in providing collective goods or coercing others into provision by committee. When there are alternative institutions in sight, the choice of one over others reflects the powerful state's valuation of the distributional consequences of that choice.[11] The emphasis of the realist's argument is squarely on power, which attaches to individual state actors; and on their interests, which are defined exogenously. The challenge is basically Mancur Olson's: how to organize collective action among rational (or at least goal-seeking) autonomous actors. The solution lies most reliably in a concentration of power.[12]

Regime theory modifies the argument to explain the persistence of institutions created by hegemons beyond the time in which power is so deeply concentrated. If states are boundedly rational and risk-averse they may well find satisfying the outcomes that institutions support, and a small group of states may share costs to sustain regimes.[13] Or elites in less powerful states may be "socialized" over time to the beliefs or the ideas of the hegemon, so that regimes could again be maintained by committee.[14] These arguments speak mostly to the problem that Keohane christened cooperation after hegemony, the maintenance of institutions constructed by power. There is no argument here that foresees a

committee forming de novo to provide a new collective good, or to create a new and different institution that is more than just the perpetuation of an extant regime. On the contrary, there are many reasons to think this unlikely. It is not hard to find the theoretical impediments to multilateral cooperation in the absence of hegemony illustrated in history, particularly when the issues are of central or vital concern to states.[15] Institutions typically founder on differing interests and the lack of sufficient power to enforce a common purpose. In an issue where there are strongly shared aversions cooperation is certainly possible; but any institutions that accompany this kind of cooperation ought to be close to the least common denominator of states' interests, the minimum needed to avoid catastrophe. Even that much is hardly assured. Quarrels over the burdens and distributional consequences of different arrangements to avoid a shared aversion could still knock states off the "pareto frontier".[16] The point is that the prospects for institutions to be created under these circumstances are at best uncertain; for a new institution that goes beyond a least common denominator in its purposes, the prospects should be bleak.

The EBRD looks a surprise from each of these perspectives. It is decidedly not a product of hegemonic power; who would be the hegemon? It is true that the US was able to negotiate for many of its preferences about what the EBRD should do, but to mistake that partial correlation for an explanation gets the story wrong in more than one way. Potential institutions other than EBRD arguably would have been more advantageous to American interests. The US did not initiate the EBRD, and American participation was not critical to its creation.[17] To the extent that the US got its way in negotiations the sources of that success did not lie in coercion, market power, or in some nebulous hegemony of ideas.[18] It is also misleading to see the EBRD as simply a perpetuation of extant regimes. While the EBRD does sit within a network of existing international regimes, it was not needed to perpetuate them. To the extent that the Bank will provide a collective good, it is a new good

in an issue-area of central importance that was not even on the international agenda in a substantive way prior to 1989. Nor is the EBRD a least common denominator response to a shared aversion. There was, to be sure, a scenario of economic failure and political instability in CEE that all Western countries wanted to avoid. Those countries did not, however, share beliefs that the failure to cooperate would cause that outcome or even necessarily make it more likely; that cooperation could prevent it from happening; or that any particular institutional form of cooperation would be worth the effort.

Efforts to support the reconstruction of CEE economies could theoretically have been "organized" in a number of different ways, and that theoretical indeterminacy is reflected in the history that this paper will recount. Strictly bilateral programs -- country-to-country programs without any substantial international coordination -- was one obvious alternative. Many American decision makers favored this approach, and it was in fact "chosen" as the means to handle a related issue -- aid to the Soviet Union -- for at least the time between the G-7 meetings of summer 1990 and summer 1991.[19] Other, multilateral efforts were also possible. Eastern Europe could have been dealt with in the framework of existing institutions - the IMF and the WB, principally - as other Americans clearly preferred. Or a new institution could have been created, but with different purposes than the EBRD - for example, a larger version of the International Financial Corporation (IFC) devoted entirely to investments in private enterprise and without political conditionality. Finally, a new multilateral effort might have included a different set of actors - to be specific, a more circumscribed set without the US, as some Europeans preferred in 1989. None of these alternative institutions emerged, but each very well might have. Nothing in what we know about the origins of international institutions excludes alternatives, or explains satisfactorily what is interesting and possibly special about EBRD.

My explanation for this new institution proceeds in three sections, in which I describe the background conditions, the process of establishing the EBRD, and the evolution of the bank generally over its first months. Particular ideas are critical in setting the agenda for this bank. The French, not the most powerful state, lead the way. The process of negotiating with other states and particularly with the US drives conceptions of interests among the major actors closer together. Bank personnel play a critical role by creating a viable intellectual and political niche for the institution. The Bank comes into being as the product of a convergence of interests that goes beyond a least common denominator or an agreement to do just what is needed to avoid a shared aversion. In doing so, it begins to define a new basis for multilateral cooperation. Reasons exist to doubt if this kind of foundation can be robust, but not all those reasons will be operative in Europe over the next decade. I discuss some of the prospects, and related issues, in the Conclusion.

III. Background: Understanding the Challenge in Eastern Europe

The issue of aid to CEE economies, made possible by the collapse in effect of Soviet power in Europe, appeared abruptly on the international agenda during 1989. The Western allies each had deep economic and political stakes in events taking place in the East, but those stakes were not equal nor were interests obviously shared. Realist vectors of interest were clearly evident within the initial approach of the Western states toward CEE, reflecting states' distinct geo-political situations vis-a-vis the East as well as positional concerns among themselves. There emerged also a set of disagreements about how best to advance change in the East even when the general direction of desired change was agreed. To illustrate this

baseline, I use several countries as examples and treat each as an actor with discrete interests.

The Federal Republic of Germany acted most quickly and decisively. On 26 October 1989, Chancellor Helmut Kohl announced that he would soon visit Poland with a pledge of between 1 and 1.5 billion dollars in aid, a larger sum by far than any other Western country had yet been moved to offer. In Warsaw 3 weeks later, Kohl exceeded expectations by signing agreements totalling more than $2 billion, 1.6 billion of which was targeted for bank loan guarantees and insurance for joint ventures. The Bonn government also promised to set up a bank in Warsaw to facilitate additional joint projects and to monitor over the long term how aid was being used. At the same time, Kohl pledged $400 million to forgive 1970s loans that Poland owed to German banks and to convert some debt into zlotys for re-investment in Poland.[20] By the following spring, Germany had agreed to cancel more than three-quarters of arrears on a Dm 1 bn loan from 1975, and had converted almost Dm 600 million of future payments on this loan into zlotys for re-investment.[21] This generous debt reduction scheme came outside of and prior to the multilateral re-scheduling arrangements for Poland that were being discussed by the Paris Club of creditor governments at about the same time.[22]

The size of the German package, its timing, and its character -- stressing guarantees for commercial bank loans and other measures to spur investment rather than new lines of open credit or trade financing -- indicated the government's interest in moving toward realizing a deep and long term perspective on ties, economic and otherwise, with CEE. For precisely this reason the German commitment caused more than a little discomfort in Poland. In January 1990, the Financial Times reported that "in Poland there is already concern that the West German investment may become so dominant it could lead to the economic annexation of Silesia, Pomerania and East Prussia, areas held by Germany between

the two world wars."[23] Alarmist as it sounds, the general sentiment did reflect a real predominance of German money moving east.[24] A July 1990 report from the consulting firm Central European Investments showed clearly the early predominance of West German capital in Central Europe, accounting at that time for 30% of total foreign direct investment in Hungary and 35% in Poland.[25] A year later, the statistics were generally similar. While accounting for 25% of total aid to CEE, German commitments made up 55% of trade and investment guarantees with less open grants proportionately than other EC countries or than the G-24 as a whole. Germany also had a great deal more contracts from the private sector backing up this large official commitment of aid.[26] All of this activity was easy to understand and in fact generally expected, given Germany's substantial available resources and its geographic proximity to the region -- which historically has given German banks and firms greater interest in and familiarity with opportunities to the East. Geographic proximity (and cultural ties) also had a clear downside risk: repurcussions from economic dislocation in the East that could be followed by migration, political instability, and perhaps worse, would be felt first and most severely by the Germans. For these reasons, Germany was going to be deeply involved in CEE regardless of what other states did and regardless, however unlikely it might seem, of any greater ambitions for re-creating a German dominated economic or political sphere to the East.

The position of France was clearly different. Lacking the power resources of Germany Paris could not hope to play on its own a role in CEE as important as Bonn.[27] The French, however, had vital interests that were affected profoundly by events in CEE and particularly by expanding German involvement there. Part of that interest lay, quite naturally, in countering or balancing German influence in Eastern Europe and in the European Community (EC) as well. Neither issue was new in 1989 but both gained new prominence in fall 1989 when German re-unification began to look inevitable.[28] Further reconsideration of France's place in

Europe, its engagement with the EC, and its singular relationship with the United States in light of German re-unification and the rush of German activity to the East brought changes in interests that were reflected powerfully in France's early approach toward CEE.

Mindful of the resource constraints that disadvantaged it in relative to Germany and even to the US, France moved to exert its own influence in CEE through different means. The strategy, in broad terms, was to make use of France's influential position in multilateral fora and international institutions, and to take a leadership role where possible. Just as the French have frequently posed as a special advocate of developing country interests in multilateral negotiations on North-South issues, now Paris would take on the same role of partnership and advocacy for the CEE countries, in particular vis-a-vis the Germans.[29] Poland was the first forum. Jean-Claude Trichet of the French Finance Ministry chaired the Paris Club negotiations on Polish debt and negotiated in February 1990 "the most extraordinary agreement we have ever had" while warning that it had to be viewed as an "interim measure before Poland's foreign debt problem can be addressed more broadly".[30] Paris then moved quickly, becoming the first Western government to make a detailed application of the bargain by rescheduling over Fr 8.3 billion of bilateral debt. In announcing this package French President Mitterrand told Polish Prime Minister Mazowiecki that he would continue to act as Poland's principal "advocate" before the Paris Club in pushing for additional debt relief.[31]

At the same time, the French government tried to promote the idea that CEE was principally a "European" issue, an area of the world where the EC states had primary interest and responsibility. Framing CEE as a third "concentric circle" of the European integration process outside the EC and EFTA was an obvious means to dilute unilateral German influence, and to keep the US at arms length at the same time. This strategy would later bring Paris into new competition with the European

Commission for a leadership role, but it still made excellent sense. If the reform and reconstruction of the East was principally a European concern, the states of Western Europe could "sit down and talk business" with the CEE countries relatively free of the burdens of cold war legacies and continuing US preoccupation with the Soviet Union as a potential adversary. The "European" focus, with its implicit promise for CEE countries that they would join naturally by stages in the integration of Europe, served French interests by countering anxieties about German predominance in the East. It was also a powerful symbol, which the French felt to be quite important at such an uncertain and volatile moment in history, of a new European political consciousness and particularly a readiness to take the reigns away from the former superpowers when it came to recasting politics on the continent now that the Cold War had ended.[32]

The French strategy in CEE was part of a larger evolution in French foreign policy generally, which for some time prior to 1989 had been moving gradually from preoccupation with Gaullist notions of independence toward a greater emphasis on European structures in economics and (more haltingly) in security as well.[33] This emphasis on European integration was challenged directly by the opening of the East in 1989. France's response, after some hesitation, was to try to intensify the process of European integration and expand its domain to include, by stages, the CEE countries.[34] Supporting this approach was an intellectual rationale that went back to Jean Monet and the European Steel and Coal Community, but which was now expanded to include a broader region and to specify particular domestic characteristics of states that would be suited to take part in the new community. In the summer of 1990 the French championed the argument that `Economic integration among democratic states that promote multi-party elections and market economies, and show respect for human rights, is a cause of peace and prosperity.' From France's perspective, the way to achieve that outcome was to "hook irreversibly the East to the West" through multilateral, integrative institutions that

would act as agents of joint progress and dilute the power of any one state -- not only Germany -- in the newly emerging democracies of CEE.[35]

Japan early on viewed CEE with an ambivalence that at times appeared close to studied detachment. This was also consistent with realist vectors of interest, given Japan's geographic and political distance from events in CEE and the miniscule Japanese direct economic stake there.[36] Japanese corporations quite early on admitted that they saw opportunities in CEE as moderate at best and would not move aggressively to invest there.[37] Tokyo's Finance Ministry was also cautious and discouraging, warning EC officials in October 1989 that Japan should not be expected "to come up with anything more than a tiny fraction" of aid for CEE and that "the sums would probably be in the range of tens of millions of dollars".[38]

While sharing generally in the economic assessment of limited Japanese interests in CEE, the Foreign Ministry and Prime Minister Kaifu also saw a valuable political opportunity in Eastern Europe, for promoting a central long term objective that they favored of moving Japan gradually toward a global political role more in keeping with its economic clout.[39] A compromise between ministries in Tokyo during November 1989 produced a $150 million package of aid for Poland as an "initial step", which was to be followed by technical assistance, food shipments, and possibly more money "once they [the Poles] work out some of their financial problems". In clear contrast to Germany, Japan's money was programmed as import credits for the purchase of Japanese products and was not aimed at promoting investment. Still, officials at the Foreign Ministry viewed this as a significant step forward, and the Prime Minister took advantage of the opening to schedule a rapid swing through European capitals in January, during which it was rumored he would offer a package of aid for Poland and Hungary totalling more than $1 billion.[40]

Kaifu's strategy was to capitalize on the opening of CEE to demonstrate in a visible but relatively inexpensive way Japan's commitment to a new political role in the world and particularly in Europe, where it would work with the Western allies to promote market-based economies and democratic reforms in the East. On January 10 in Berlin, Kaifu announced that the Ex-Im Bank of Japan would commit a total of $1 billion in loans to Poland and Hungary over the next three years, and that the Japanese government would add $350 million in trade insurance for Poland specifically.[41] The Prime Minister pitched this as a political signal to the West and while it was clearly intended also as a signal to Japanese corporations that they had "official blessing" to explore E. Europe, both signals fell relatively flat. The Japan Economic Journal reported that Kaifu's speech was received skeptically at home, because the initiative was seen as coming under pressure from Western European nations and the US.[42] Other government and business officials cautioned that regardless of Ex-Im Bank credits or anything else, Japanese corporations would still not look at CEE seriously unless assured that the EC would be willing to import end products from Japanese factories located there.[43] While Japan was hailed as a "good friend and partner" by the governments in Warsaw and Budapest, the reception in Western European capitals to Kaifu's initiative was decidedly more chilly.[44]

Japan has not in fact taken a significant economic stake in CEE. By the summer of 1991, Japan had pledged only 7% of the total aid offered to CEE and most of that came in credits and trade guarantees.[45] A highly visible joint venture project in Hungary that was announced during Kaifu's visit made Suzuki the first Japanese company to set up manufacturing autos in E. Europe, but this was a deal Suzuki had been contemplating for more than 5 years -- and it did not by itself signal any significant trend toward broader Japanese investment interest in the area.[46] Additional planned projects were soon reported to be sidetracked by "confusion in the region stemming from the sweeping political changes taking

place".[47] Even after the prominent Industrial Bank of Japan released an optimistic economic forecast for the former East Germany, Japanese firms remained mostly on the sidelines.[48] A MITI official in early 1990 admitted that even in 10 years time the government could not foresee Japanese trade with Eastern Europe rising above 1% of total trade.[49] In sum, Kaifu's fervent effort to nurture Japanese interests in E. Europe, for whatever reasons that effort was made, seemed moribund. Given the unfamiliarity of Japanese corporations with CEE, strong EC resistance toward opening markets for CEE products made in Japanese factories, and the perception that there were better opportunities elsewhere in the world judged on strictly economic criteria, the Japanese could not be expected to have a major interest or to take a substantial role in the economic reconstruction of CEE.

The US government looked at the changes taking place in CEE at first with a sense of incredulity; yet as it became clear in fall 1989 that Gorbachev's signals about the future there were not just rhetoric, the Bush administration moved quickly (more quickly than many of its critics suggested) to appraise relevant American interests and capabilities. The US found itself in a position nearly reverse to that of Japan: with substantial interests in CEE and in related issues, the US was hamstrung by constraints in both the official and the private sectors to make those interests felt.

One of the constraints facing the US early on was the perceived connection between CEE and US-Soviet relations. For a time, US decision makers felt they had to tread lightly in the former empire of the USSR, for fear of upsetting a delicate domestic balance in Moscow between reformers and other less progressive factions. As that concern faded gradually the force of a deeper constraint -- shortage of money -- came powerfully to the fore. The Polish story serves again as an example. In September of 1989, the Bush administration found itself under considerable pressure from Congress to boost official assistance to Poland,

following a series of meetings with the new non-communist Polish Foreign and Finance Ministers.[50] In an acknowledged attempt to head off a larger Congressional effort, the White House reluctantly agreed to add $200 million to its Polish aid package in October, despite the worsening budget situation in Washington.[51] After negotiations with the White House, the Congress approved in November the Support for East European Democracy Act of 1989 (SEED) which included funds of $850 million over three years, heavily weighted toward long term credits and guarantees with relatively little immediate cash. The President signed this bill, although he made known his view that it was fiscally irresponsible and that it was double in dollar terms what the White House had wanted.[52] Financial constraints were evident also in the 1990 Foreign Aid bill where Poland, described as the "big winner", received only $225 million in cash assistance for its economic transition.[53] By the summer of 1991, the US had pledged only 8% of total aid to CEE, although the money came disproportionately in grants.[54]

The President's "fiscally responsible" alternative was to use what official aid the US could offer not for direct assistance per se but rather as "seed" money, to coax private American firms and investors toward CEE. Central to this effort were Clayton Yeutter, Robert Mossbacher, and John Macomber, all former prominent businessmen whom Bush tapped to help propel this agenda via administration bureaucracies as well as the revitalized Overseas Private Investment Corporation, Ex-Im Bank, and new American Enterprise Funds for Poland and Hungary.[55] Unfortunately, neither American corporations nor American banks (which I discuss later) quite rose to the occasion. Several large projects by American multinationals notwithstanding, US firms for the most part found CEE to be unfamiliar territory with highly uncertain business prospects. Difficult access to financing, problems with convertibility and repatriation of profits, and the lack of sturdy capital markets in these countries contributed to a general sense among American firms that there were better short term prospects elsewhere -- and the long term was not sufficiently

bright or clear to bet on as yet.[56] In June 1990 a prominent American businessman with exceptional ties to CEE warned Congress of the "general irrelevance of America" to the economic future of CEE and noted that "a year after President Bush announced the American Enterprise Funds for Poland and Hungary not a penny has been invested."[57]

These constraints notwithstanding, the United States recognized early on a number of crucial interests which it sought to press in CEE. The most obvious interest, to promote rapid economic reform and liberalization in the formerly socialist economies, was important for a number of reasons. First, CEE offered vast opportunities for Washington to champion its economic ideology agenda, stressing free markets, private control, and the removal of state intervention in economies as the path to prosperity. At the same time, rapid and massive economic reform would consolidate the overthrow of the socialist bloc in Europe and reduce further any lingering Soviet influence in that part of the world. Success in dismantling state controls over the economy would also accelerate the CEE countries toward readiness for some kind of association with the EC, to end finally the post-war division of Europe and insulate them further from any negative shifts in Soviet politics. While speed had to be measured against the potential for short term political instability in CEE which, even if localized, could threaten the strained trajectory of reform in Moscow, the US had reason to back strongly CEE reformers who dismissed "half-way houses" between socialism and capitalism in favor of rapid massive transformation of their economies.[58]

Events in CEE also offered Washington a unique opportunity to reshape in important ways the nature of the American presence in Europe and the relationship between the US and the European community. With the Cold War seeming at an end, it made sense for the US to reduce somewhat its security obligations on the continent, while taking the same chance to boost the terms of its economic

relationships there. The US was less concerned by dreadful scenarios of German domination of CEE than it was worried about moderating other country's concerns regarding Germany.[59] These issues came together as part of a general perceived interest in supporting the continuing process of European integration and, importantly, nudging the EC toward a less insular, more outward-looking orientation.

This was more than simply a reprise of old arguments about burden sharing. In economics, CEE reform presented the US with another chance to push against the EC as "fortress Europe" in favor of an EC that would act as a constructive partner in monetary issues and, more immediately, trade. The community's common agricultural policy (CAP) was the most conspicuous manifestation of the insular EC -- and the US had an obvious common interest with CEE nations in fighting the CAP. There was also a perceived interest in pushing the EC to look outwards on foreign policy issues more generally, given the strong sense in Washington that in most areas of common concern the US and the EC would share complementary, or at least reconcilable views.

This was not a new effort but it was given new impetus by the impending end of the Cold War. As early as May 1989, President Bush called for the EC to establish with the US "new mechanisms for consultation and cooperation on global political issues". This led to a joint "Declaration on US-EC Relations" in November 1990 establishing regular high level bilateral meetings between the Community and Washington, and Secretary Baker's suggestion in Berlin the next month that the US and the EC might consider soon signing a formal treaty.[60] Based on the notion that "a European union will assume a place as a responsible leader contributing to the strengthening of structures of global as well as continental interdependence", Baker in 1991 called on the EC to demonstrate its foreign policy competence specifically by "reaching out to the East" by which he meant Eastern Europe.[61] From the

American perspective, this was a natural evolutionary path for Europe to follow. For US-EC relations, the preferred path led away from the possibility of a segmented, multipolar world of parochial regions; and toward effective international cooperation among generally like-minded states with combined capabilities to act effectively on the world stage. CEE was the obvious place to begin making that vision real.

Confronting Change in Eastern Europe

When the G-7 countries held their regularly scheduled annual summit in July 1989 at Paris, (the "Paris Summit of the Arch"), it was already clear that massive political change had begun in CEE. They agreed at Paris to begin immediately a coordinated program of assistance to these countries, and to encourage a larger group of Western industrialized countries to join in the effort. This led to the birth of the G-24 the next month.[62] Importantly, the G- 7 decided that this new aid program should be organized and chaired by the European Commission (which remains in charge). It also agreed on priorities for G-24 aid (emergency support, food, technical assistance, vocational training etc.) as well as a general principle of political conditionality, that assistance would be provided only to countries that could make "clear commitments regarding the rule of law, respect for human rights, the establishment of multiparty systems, the holding of free and fair elections in the course of 1990, and economic liberalisation with a view to introducing market economies."[63]

Despite the different positions and interests of the G-7 countries in relation

to Eastern Europe, these agreements came relatively easily. There was nearly full consensus on the notion that aid should be subject to political conditionality.[64] This principle was reinforced and made more specific when in December the G-24 agreed to extend its aid program to Czechoslovakia, Bulgaria, Romania, and Yugoslavia "at the time they put into place the necessary political and economic reforms".[65] There was also general agreement that the European Commission should be charged with primary responsibility for the program. President Delors' interest in having the EC per se take on this new task was obvious; at the same time, the incremental nature of the aid being provided eased possible objections from the larger member states that might otherwise have seen the Commission as usurping their perogatives. By right of interest, exposure, and capability, Germany would have been the state most deserving of leadership in the G-24 but the German government neither sought this role nor objected to the Commission. The US also supported strongly EC leadership. One argument was that since the EC would be the short term beneficiary of reform in CEE it ought to be the EC that put up most of the assistance money and ran the program.[66] This rationale was pitched as common sense pragmatism, which it was -- but only given Washington's perceived interest in nudging specifically the Community and not the individual countries of Western Europe toward a more confident foreign policy role.[67] For the moment, there seemed to be general agreement among the major Western Powers on what and how much needed to be done immediately by donor governments vis-a-vis CEE, as well as who should lead in doing it.

Part of that consensus, specifically how much needed to be done by governments, came under pressure quickly as the pace of change accelerated unexpectedly in the East. The scope and limited magnitude of the G-24 program was based on the presumption that official aid to Eastern Europe would fill emergency needs and then play only a minor role to facilitate the movement of private capital investment into the longer term tasks of reforming and privatizing

planned economies. That presumption turned out to be too hopeful, as it became increasingly clear that private money from the West would not flow toward CEE in anything like the requisite amounts, at least in the short term.

Limits on what large commercial banks were going to do were most obvious quickly. The large commercial banks were significant sources of capital for CEE between 1985 and 1989, but new lending slowed as uncertainty increased with the process of political reform in specific countries.[68] The North American banks, which were not in any case heavily represented in earlier lending, became gun-shy even more quickly than their European and Japanese counterparts which had larger stakes in the region.[69] All of the commercial banks were alerted further by calls for a Brady Plan - type debt rescheduling for Poland and then by explicit pressure from the Paris Club governments to follow its lead after the first agreement on Polish debt owed to governments, in February 1990.[70] Lending slowed further as creditworthiness continued to deteriorate all over the region, complicated by the want of reliable and timely data on overall debt, economic performance, and legislative reform. One prominent Western banker argued in March 1990 that "for general balance of payments lending to central banks, the book is closed" and that only project lending driven by banks' major corporate clients, and even then mostly for projects that could generate export earnings (and thus foreign exchange), would go forward in any significant measure.[71] The recession of 1990 made matters worse for all borrowers but the effects of slowed lending were felt in CEE most of all.[72] Other sources of private international capital were not very much more forthcoming, at least initially.[73] As the estimates of the capital requirements to reconstruct CEE economies soared, it was becoming painfully obvious that private finance was not going to come anywhere near to meeting those needs.

With that recognition came a nearly inevitable conclusion: Western governments would need to take the lead to magnify many times capital flows to

CEE. But that conclusion in itself did not determine the shape of the effort or its institutional form. Aid could have been organized on a bilateral basis through national agencies; or on a multilateral basis through the coordinating mechanism of the G-24, the more formal multilateral mechanisms of the Bretton Woods Institutions (BWI: the IMF and World Bank), or perhaps through an entirely new institution.

The last possibility was bound to be controversial. This could be even more so if -- as seems likely -- there would develop some "mixture" of these different institutional forms. Setting up a completely new institution would be costly. It would also mean opening up a thorny set of problems among states -- who would pay, who would decide, etc.-- that were settled de facto for better or for worse in extant institutions. At the same time, there was the powerfully suggestive precedent that other "underdeveloped" regions of the world were graced with their own development banks separate and apart from the BWI. There was also a broad sentiment that 1989 represented a sharp break in history and that creating a new institution, devoid of Cold War legacies, might be sensible for that reason. It was almost inevitable that at some point, the concrete suggestion would arise to set up a new development bank of some kind for CEE.

Given the set of interests that I have described for several key states, it was also to be expected that enthusiasm would be mixed. Consider the following as baseline preferences, which I derive from the realist vectors of states' interests vis-a-vis CEE. Germany might have been resistant to the idea. From Bonn's perspective, a new multilateral development bank would look at best unnecessary; at worst it could be seen as a means of diluting the predominance of German investments in the region by increasing the presence of other countries while crowding out private banks. Even worse, Germany might have been expected to foot a substantial portion of the bill. Japan might have been mildly interested, as a

relatively inexpensive means of keeping the door to CEE open while monitoring the state of legal, financial, and industrial infrastructure there that might make prospects for future investment look promising. The Japanese also would have had a moderate interest if involvement in such an institution promised to better their difficult economic and political relations with the EC; certainly, if the other great powers including the US were going to join in creating a new bank the Japanese would not want to be excluded. The French would have had reason to be much more enthusiastic. Creating a new multilateral institution would not only serve to dilute German leverage in CEE; if that new institution were to be cast as specifically "European" in character the French could advance a leadership claim that, if successful, would enhance the French position vis-a-vis not only Germany but also the European Commission, and the United States. The basis for that claim would be the special role that Paris had tried to carve out for itself as advocate for CEE interests, and it would be consistent with French sponsorship of the "concentric circles" concept for the Community.

The US might have been in the most ambivalent position. It was becoming clear that American banks and American firms were not on their own means going to be aggressive actors in CEE; they might very well find themselves shut out in effect from the best opportunities unless there were some kind of international effort to establish more sturdy foundations for investment there. Washington had a definite interest in making use of IFIs to parlay its own limited capabilities to cultivate that foundation, but the obvious way to do that was to focus on the World Bank and IMF where the US had most influence. There was ambivalence here because at the same time, Washington's evolving foreign policy vision for US-EC relations suggested interests in seeing new "European" institutions grow up, so long as they did not marginalize US concerns. These political considerations were tempered, however, by an abiding skepticism over the economic orientation of IFIs overall and regional development banks in particular. Even if the political arguments for a new

multilateral institution had been airtight, the US would have hesitated to join in creating for CEE a development bank that looked like it might recapitulate even without intending to do so the experiences of such banks in Latin America, Africa, and even Asia.

Confronting the Legacy of Multilateral Development Banks

This was not a new skepticism.[74] In principle, the US government in the 1980s was willing to concede that multilateral regional development banks could play at least a marginally helpful role in economic development, if they were set up and run efficiently. On the US logic, this meant that the primary role of such banks ought to be enhancing the flow of private investment capital to underdeveloped areas and helping that capital to find economically viable projects. Another favorable argument more prominent by the mid 1980s' was that channeling aid through multilateral banks made it more difficult for individual state donors to pursue through foreign aid programs parochial or self-interested objectives vis-a-vis vulnerable recipient countries, while multilateral banks could be more successful than individual donors in exerting general macro-economic leverage on recipients.[75] When the question arose for CEE, at least the possibility of a useful role for regional development banks was generally appreciated in Washington.

But in 1989 and in fact for much of the preceding decade, US administration officials were outspoken critics of the shortcomings of these banks in practice. The most outspoken echoed in spirit radical criticisms of regional development banks as lavish soft-loan windows and give-away programs for countries with socialist-

oriented economies, or (slightly more generously) as dedicated supporters of inefficient public sector enterprises in developing countries, at the expense of the private sector.[76] Some criticisms were exaggerated, but the more mainstream arguments -- which claimed among other things that regional development banks emphasized at times loan quantity over quality, and had not developed effective policies on "graduating" soft- window borrowers to less concessionary terms -- had a point. The most important and sweeping criticism was that development bank financing practices did not promote sufficiently the growth of the private sector in preference to the public sector in countries of operations. This was not a new complaint, but it achieved new force under the Reagan administration during the early 1980s. An influential 1982 Treasury Department Study found that "direct support from multilateral development banks to the private sector had lagged in recent years" and that the "focus of the development banks' lending programs in general were geared toward promoting state-owned enterprises in a wide variety of activities in many cases where we felt that there were appropriate alternatives...but the development [banks] were not doing very much at all in the area of trying to find alternatives".[77]

Direct loans to member countries for large, state-sponsored investment projects have in fact been the main business of multilateral development banks. The reasons for this lie first in the articles of association of the banks, which at the time of their writing reflected both operational realities and the intellectual justification for creating the banks at all. The World Bank charter, for example, obliges the bank to lend in effect to the public sector, since it requires a guarantee from the member government in whose territory a project is located in each case where the borrower is not the government itself.[78] A major motive for this restriction was to safeguard the bank's credit rating so that it could borrow on the international bond market at priviledged rates and pass those savings on to poorer countries; another reason was that the kinds of projects the bank was supposed originally to support --

major infrastructure and the like -- were generally considered as being the responsibility principally of governments and not private enterprise. Among the regional development banks, only the Asian Bank is not saddled with a similar restriction, and it has not in practice focused strongly on the private sector.[79] The small amount of lending these banks have done to the private sector has typically been channeled indirectly, through national development finance institutions and other intermediaries which then "on-lend" funds to private or semi-private enterprises. Most development finance institutions are, however, controlled by governments and are not subject in practice to market discipline. These lending programs have remained small because their results have been disappointing.[80] It is hardly surprising that the MDBs, which for most of their postwar history lacked both a mandate and appropriate operational facilities for private sector operations, developed expertise elsewhere by focusing more intently on what they could do well. If there was indeed a conservative MDB "corporate culture" that favored large loans to state- owned infrastructure projects, as critics charged, that was a natural product of what these banks had been established to do.

The problem was that the intellectual rationale for development lending had evolved over time away from public sector support while the banks themselves were slow to adapt. Signals of the width of that disparity were becoming increasingly common, particularly in American complaints about MDB practice, by the mid 1970s. The critics' argument at that time was that the World Bank's lending practices were yielding mostly "one time transfers of wealth" to the public sector, rather than "increased productivity, capital formation, and technological advance" which were more likely to emerge from the private sector.[81] The MDBs' explicit policy to eschew political considerations in lending decisions was also a target of attack, particularly when it came to issues of human rights.[82] Concerns with democracy and with sensitivity to environmental impact of projects would come to the fore later, in the 1980s. By the time they did, there was adequate evidence to

convince many in the US and elsewhere that the overall economic practices of the MDBs, however modified over the years to take account of different development philosophies, would remain out of place so long as the focus remained on the public and not the private sector. On that logic, import substitution vs. export promotion and similar arguments were part of the wrong debate; private vs. public sector or, to be more precise, market-oriented vs. state-allocated, protected, and monopolistic, was the right one.[83]

By the end of the 1980s, emphasis on creating a competitive environment across major economic sectors had become the baseline argument among the advanced industrial countries, if not yet among the majority of less developed countries. Two points stood out. The first was that countries should in general strive to reduce the role of the state in the economy.[84] The second was that for less developed countries suffering from shortages of capital, the major goal of external assistance ought to be to facilitate the flow of private investment toward the private sector. Although a broad scope of activities could fall under that mandate, including careful lending to governments for public sector infrastructure projects in support of the private sector, the burden of proof under this philosophy would clearly lie with any public sector proposal to demonstrate that it would in practice promote further private investment and the expansion of market mechanisms in the economy. The point was to reduce protection and barriers to entry in all spheres of economic activity, and thus to promote competition from both domestic and international sources.

MDB practice did undergo some substantial change during the 1980s in response to these arguments, although more convincingly in the realm of general macroeconomic policy than in project lending per se.[85] The World Bank after 1981 moved toward what it called a "balanced strategy" with a new emphasis on growth as well as poverty alleviation, and began providing to debtor countries sectoral and

structural adjustment loans that were tied to public finance austerity and privatization programs.[86] The Bank in 1983 also began to experiment more broadly with co-financing programs designed to promote more effective cooperation in project lending with commercial banks.[87] In 1988 the Bank began to develop annually country-specific strategies aimed specifically at supporting private sector development.[88] The Asian Development Bank launched in 1983 a small program to take equity positions in private enterprises and made its first loans without government guarantee in 1985. The Inter-American Development Bank established in 1986 the Inter-American Investment Corporation, an IFC-type merchant banking affiliate that makes loans and equity investments in private enterprises in Latin America.[89] These regional development bank programs were certainly small -- the Corporation for example was capitalized at only $200 million and in 1990 approved just over $66 million in financing -- but significant nonetheless for the change of MDB lending practices they were beginning to denote.

Pressure from the US Government was an important source of these changes. Acknowledging that the banks themselves were reluctant, a senior US Treasury Official noted in 1985 that the Reagan administration had "been very aggressive" and had "pursued in each of these institutions through different mechanisms an attempt to get the Banks to recognize that there is more that could be done in a development sense beyond just doing government to government activities and that there is a real role here for the private sector to be encouraged and to be nourished".[90] The pressure was maintained and in some instances raised by the Bush administration after 1989. By 1991, the US had escalated the debate with the World Bank, to the point where the Treasury Department was insisting that the World Bank commit to directing one-half of its loans toward the private sector by 1995.[91] The US backed off this extreme demand but did in June 1991 ask some specific changes in the management structure of the bank to make it "more aware of private sector considerations", as a condition for supporting a major capital increase

for the IFC.[92] This was settled by compromise, after the bank board showed its pique at US pressure.[93]

But if the US was most strident in pressing for the application of market principles to development economics, it was by the mid 1980s hardly isolated in that conviction. World Bank officials were certainly annoyed by the scope and the tone of US demands but they were not without sympathy for the underlying message. Indeed, the bank had already made its own substantial philosophical adjustments toward greater emphasis on the private sector and looked set to go considerably further with commensurate changes in lending practice that it had begun to implement earlier in the decade. The Bank's 1991 World Development Report argued explicitly that private sector growth driven by market prices, open trade, and competition, should be the central concept of development strategies throughout the world; and set the bank to the task of supporting such strategies.[94] This reflected the deeper underlying consensus among the Western industrialized countries about the contribution that MDBs could make to enhancing the competitive environment in developing countries' economies. Agreement did not extend to the details of practice: there was considerable room for controversey about precisely how much developing countries should rely on the state to provide essential infrastructure, health care, education, and the like. There were also debates about the importance of patterns of ownership, specifically whether state owned or managed enterprises could in practice respond as efficiently as private firms to signals from a competitive economic environment. But the core of the consensus -- that the key to development lay in market competition and ultimately in the private sector -- was evident. That consensus would emerge more clearly and be reinforced in the process of setting up a new bank for CEE.

IV. The Founding of the EBRD

In the last section, I set the background for EBRD by describing briefly some ways in which events in CEE engaged the interests of several key Western states. Although the specific challenge was new, interests were not free-standing. I proposed that any suggestion to establish a new development bank for the region would have had to confront not only those interests but also the historical legacy of extant MDBs, against the backdrop of an evolving consensus on development lending that did not for the most part view that legacy kindly. At the same time, governments in the West were coming at an uneven rate to the recognition that private sources of capital, investment, and expertise would not by themselves come close to answering the needs of CEE reform. In this section I show that over the course of 1990 consensus on that point went several steps further. Key elements of institutional, legal, financial, physical, and perhaps even cultural "infrastructures" were missing from these countries[95]. Aversions to a future scenario of failed transformations raised what had been seen as a possibility of Western governments acting more aggressively in support of CEE reform to the realm of perceived necessity. But the intensity of that perception varied, and it did not determine either the form of support or the degree to which it would be coordinated among differently interested governments. Decisions to explore the possibility of a cooperative venture at this point were critical. Negotiations over the shape and scope of a proposed cooperative endeavour led to the emergence of a deeper consensus that went beyond shared aversion. The key Western players discovered that they also shared a set of ideas about broad goals to be sought in CEE. One of these goals was the intertwining of democracy and other political reforms with market economies, to "produce" states that could prosper domestically and live with each other comfortably or at least peaceably on the European continent. A second

was to make the initiative principally "European".[96]

These shared ideas about goals made the EBRD, a cooperative outcome, viable in several ways. They bounded the range of possibilities for cooperation that were perceived by the central actors and mitigated distributional concerns that could have been much more serious, in terms of both the economics and politics of who would pay and who would benefit from CEE reform. These ideas also eased bargaining over methods of cooperative action, how a new international institution should function generally in support of CEE reform. There remain substantial differences of opinion over tactics, the specific means of dealing with the many problems the effort faces in practice. But the basic questions -- whether there should be a European bank, what kind of a bank it should be, what role the US, the Soviet Union and later the ex-Soviet republics should play in it, and how it should negotiate the delicate path between political and economic objectives in its countries of operation -- have for the most part been settled, in ways that stand to reinforce over time the bank's mandate among its powerful member states.

Fall 1989: The French Initiative

Following the G-7 decision of July 1989 to entrust to the European Commission primary responsibility for coordinating Western aid to CEE, it became increasingly clear to officials in Brussels that the US was not in fact aiming to play a leadership role in that part of the world but would support actively policies it deemed sensible that were initiated by the EC.[97] With an emergency food aid package of $275 million already pledged, the Commission in September proposed

that another $650 million be spent over the next year in Poland and Hungary, also mostly for emergency aid. Polish Finance Minister Leszek Balcerowicz called this "an encouraging sign" of multilateral assistance but emphasized Poland's greater need for long term support of fundamental economic reforms and not just emergency food stocks.[98] Most of the significant longer term aid in the fall of 1989 was coming through bilateral channels, and most of that from West Germany.[99] It was in the context of early public murmurs of concern about that issue that the French broached first the idea of setting up a new international institution to direct aid toward CEE. Speaking before the European Parliament on October 26, French President Mitterrand called on his EC partners to coordinate more closely their long term aid plans and "urged that Western European nations form an investment bank to provide loans" for "modernizing" the economies of CEE.[100]

Jacques Attali, at the time special advisor to Mitterrand, took charge for developing the President's vague proposal. Under his guidance, the debate would expand quickly to encompass more than the issue of a new multilateral development or investment bank, controversial as that would have been on its own. Attali seized on Mitterrand's demarche to push forward a broader agenda. The proposal as it emerged at this time was to create a novel "European institution" that would symbolize the independence of Europe and its new self-confident responsibility at the end of the Cold War. This implied a very broad mandate for what the new "bank" would do in CEE, and at the same time a narrow membership. The "maximalist conception" advanced by the French in Fall 1989 saw the bank as taking on primary responsibility for all existing multilateral aid programs aimed at CEE, including the EC PHARE program and the Polish Currency Stabilization Fund; as well as supplanting the emerging interests of the World Bank and the IMF in this part of the world -- and thus going far beyond the typical role of a development bank. It also envisioned a restricted membership, or at least severely

restricted power for non-European states. "European", as defined by the French at this time, did not include the United States as a principal actor.[101]

These concepts were developed into an initial brief that was presented to an impromptu summit of EC leaders, called in Paris on November 18 for consultations on the fast-moving events in the East. At the end of this meeting, Attali expressed concern that summit participants did not take the BERD (Banque Europeenne pour La Reconstruction et le Developpement, as it was now called) as a particularly serious initiative and were not prepared to move quickly and aggressively toward establishing the bank.[102] The latter supposition may have been warranted, but the former was not. Commission officials at least took the French proposal quite seriously, if for no other reason than it represented a threat to the Commission's new-found responsibility and authority, since the maximalist conception of the bank (if it came into being) would usurp in effect the Commission's role as principal coordinator of aid and representative of the Community -- indeed, of the G-24 - in CEE. That role would pass to the Bank and by implication to the French, who would assume naturally the leadership role in this new "European" but specifically <u>not</u> "European community" institution.[103] Even if unlikely, that possibility was not going to be ignored in the uncertain and rapidly changing environment of fall 1989. While the summit did give "provisional approval" to the general idea of BERD, it did not specify how broad the Bank's mandate was expected to be or how restricted its membership.[104] To consider those issues and others, the European leaders established a committee under the Troika to produce a study that would serve as the basis for further discussions about the BERD under Community auspices.[105]

Meeting just a few weeks later on the 8th-9th December at Strasbourg, the European Council endorsed officially the BERD as a bank whose "main task would be to develop the competitive productive sector" in CEE. This charge reflected a broad agreement among the 12 that the BERD should not recapitulate the experience

of other regional development banks' emphasis on the public sector, but it did not foresee any formal limits on the bank's lending practices. The goal was to give the bank sufficient flexibility that it could do easily what other development banks have often found hard to do in practice: to focus on lending that is directed toward the general goal of the growth of the private sector.[106] But while this economic rationale was shared essentially with the earlier French proposal, two other things about the bank -- concerning specifically political aspects that made up the "maximalist conception" -- had been changed. The mandate for the bank had been narrowed considerably to a "minimalist conception". While the bounds of what the bank could do were not fully fixed, it was now clearly intended that the bank not seek to act as the international community's primary interface with CEE, but rather complement and cooperate with other institutions. And while the Strasbourg declaration preserved the notion of the bank as a new "European institution", what it meant in effect to be "European" had been modified. As proposed at Strasbourg, the membership and shares of ownership of the bank would be the member states of the Community, as well as the Community itself and the European Investment Bank at 53%; other European OECD countries at 10%; non European OECD countries at 22% of which the United States and Japan would each have an 8.5% share; and East European Countries and the Soviet Union together at 15%.[107] This membership profile included the unprecedented step of making a non-state actor (the EC itself) a charter member of an IFI, which suited well the Commission's interest as part of its competition with the French for leadership.[108] It also symbolized a concept of Europe which, while not really including the US as a full member, did reserve the most special place for Washington in the external relations of the Community, and in its evolving association with CEE.[109] The "bank" that emerged in conception from Strasbourg thus looked different in several respects politically from what the French in October had envisioned: it would be smaller in scope, broader in membership, and with an identity more closely tied to the European Community per se.

While Attali and other French officials were not entirely pleased with these changes, the more troubling aspect from their perspective of Strasbourg was their sense that the general goal of setting up a new bank for CEE had been given only lukewarm endorsement. Fearing this meant that the project would now flounder in a limbo of community politics, Mitterrand responded by taking back the initiative. Several days after Strasbourg, the French President on his own authority sent a letter to 40 heads of state inviting them to a January meeting in Paris for the purpose of drafting articles to create the bank.[110] Mitterrand's demarche was critical in a number of ways, apart from setting off what Attali later called a "strategie du fait accompli" for establishing the EBRD.[111]

For the first time, the purposes behind this initiative were expressed formally and explicitly to a broader audience beyond the 12. The vision was articulated as an extension of the European Community itself: that economic development plus integration would bring peace in Europe, via prosperity and interdependence among democratic countries sharing commitments to human rights, multiparty elections, and free market economies. The EBRD was to be the handmaiden extending this package to Eastern Europe. At the same time, the EBRD would be a "state of the art" financial institution that would incorporate lessons about development lending, and aim specifically to support the private sector. Finally, the EBRD would embody a political rationale for a new "European institution" that was broader and more inclusive than the French plan originally conveyed.

"Europe", as defined at this point within EBRD, did not include per se the US but it did reserve a special place for Washington as the key supporting actor. As for the Soviet Union, Mitterrand's decision to include Moscow among the recipients of his letter made Soviet participation as a charter member nearly certain - although whether that meant full and equal participation was still unclear. For the

other members of the 40 and particularly the non-European countries of the OECD, the invitation signalled that the first new and specifically European institution of the post cold war world would bolster the trend against "fortress Europe" strands within the integration process that were a continuing subject of concern.[112] Lastly, while Mitterrand's move re-affirmed French leadership in setting up the EBRD and established finally that the bank would be an intergovernmental not European community endeavour, it also reserved a special place for the Commission and thus for the EC in its own capacity, apart from the 12 member states.

Winter 1990: The Bank Takes Shape

At a Bush-Mitterrand mini-summit meeting held in St. Martin on 16 December 1989, French and American officials discussed for the first time in detail the proposal to establish the EBRD.[113] The Americans were generally cool towards the project overall and raised a series of specific questions about the logic of US involvement. Some officials from Department of Treasury argued directly against the bank on economic grounds, proposing that left to its own devices the "market" -- meaning private investors -- would provide sufficient and appropriate capital for the needs of CEE. On this logic, the bank was unnecessary at best and could be positively harmful to the development process in the post-socialist economies, given the mixed record of other regional development banks. When the French argued that a new regional institution with a small set of target countries had the potential to act differently from other development banks, the Americans asked whether existing institutions, specifically the World Bank and the IMF, could not meet adequately whatever need might in fact be indicated for multilateral aid, without the expense and delays of setting up a new bureaucracy.[114] State

Department officials were more sensitive to the French ambition to create a specifically European institution, but were leery of having the first new European institution fall under the purview of finance not foreign ministers.[115] Both State and Treasury also had serious political concerns about the issue of Soviet participation, and did not want to see the EBRD establish too easily a precedent for Soviet "entree" into other international institutions financial and otherwise. Yet while there was considerable discomfort among American officials over all these points and generally over the sense that the US had been excluded from the early stages of planning for the bank, brought in as an afterthought, and presented with a kind of fait accompli by the French, there was also solid sentiment (particularly on the part of White House officials) that Washington not seem disinterested in this pan-European project in the first months of the post cold war world. This seems to have been the decisive reason why the US accepted Mitterrand's invitation to join in the negotiations, although no commitments were made as to final US participation in whatever the results might be.[116]

Anticipating the intergovernmental conference to be held January 15-17 in Paris among 34 nations that accepted Mitterrand's invitation, Ireland as new President of the EC convened among the 12 a set of preparatory discussions in Brussels during the first week of January. Efforts here to forge a single EC negotiating position did not go entirely smoothly. The French continued to push for a bank larger in scope with an initial capitalization of ECU 15-18 bn, while most other EC members backed 10bn. The French also wanted flexibility for the bank to lend unspecified amounts to public sector infrastructure projects as well as private enterprises and supported the selective use of concessionary lending at below market interest rates. The British opposed these ideas, arguing that both contravened the lessons from development lending at other regional banks. With support from the Netherlands, Britain sought a ban on concessionary lending and tried to limit the bank's capital to about ECU 5 billion, all of which would be committed to support

the private sector only. Ireland continued to push for a leading role within the bank for the Commission, proposing that the 12 together take 43% of shares and the EC itself take 10%, which would have made the EC the single largest shareholder.[117]

While these positions reflected particular conceptions of interests among the EC 12, one central point -- that the principal purpose of the EBRD would be to support the private sector in Eastern Europe -- was not at issue. Nor was there any serious objection to certain general operating principles to facilitate that aim: it was agreed for example that the bank should be able to go beyond government-guaranteed loans, to provide unsecured debt and take equity positions in some private enterprises.[118] Concentrating on this core consensus helped produce a compromise plan that would be the basis of the wider discussions in Paris.

Chairing the meetings on January 15-17, Attali presented the Community's plan to the first intergovernmental constitutive conference. He proposed that the bank be capitalized at about ECU 12 billion, with the EC 12 taking just over 50% of the shares and controlling more than 1/2 seats on the board. By country, Britain, France, West Germany, and Italy would each have 8.5%, but so would the US, Japan, and most notably the Soviet Union.[119] The bank would stress lending in support of the private sector but would not be limited by statute for this purpose, and it would not necessarily shun state-owned enterprises so long as they were slated for privatization or operating in competitive sectors. At the same time, it would not make concessionary loans except as the agent of others, through special funds contributed for its management by member states.

When presented in general symbolic terms as a new European institution the EBRD received a preliminary endorsement from most if not all of the conferees.[120] This rested substantially on a broad agreement about political conditionality. Extending the precedent of the G-24 program, it was agreed in principle that the

EBRD would adopt explicit criteria of political behavior for borrower states, extending to terms like multiparty democracy and respect for human rights.[121] On political grounds, this distinguished sharply the EBRD from other MDBs. The EBRD was also distinguished in economic terms, as a "state of the art" financial institution committed first and foremost to the growth of the private sector. At a press conference closing the meeting, Attali predicted jubilantly that the bank could be born by the Spring and begin its operations in just about a year.[122]

Other participants found that prediction surprising and too hopeful. While there was general agreement on the main principles that should govern the activity of a new bank if it were to be created, there was not widespread enthusiasm for it, nor was there a strong sense that the project should be handled as a priority.[123] What's more, a number of major issues remained subjects of contention among the powerful states. While the amount of capitalization was now agreed at ECU 10bn, the distribution of shares remained a problem. No one contested seriously the principle that European Community members should together have a majority, but the question of how that majority would be assembled among member states' shares and whether the EC would have its own significant share was not settled.[124] The place of the Soviet Union was also at issue. The US and Britain were adamantly opposed to an equal membership share for the Soviet Union and did not even agree that Moscow should be a member on normal terms, or be permitted to borrow from the bank.[125] Finally, there was continued disagreement over what kinds of projects the EBRD should be allowed to fund. While Attali argued for the French and most of the other EC members on behalf of flexibility, maintaining it "unreasonable" to exclude from the EBRD's mission some support for public sector infrastructure projects, the US and Britain stuck to the position that EBRD funds should go exclusively toward private enterprises or enterprises moving irreversibly toward privatization.[126] The conference closed by setting up three working groups to study these issues as well as the thorny question of where the bank should be based,

in anticipation of another large meeting the following month.

The February conference, which began to explore in greater detail some issues about how the bank would operate in practice, was predictably more contentious. US representatives in particular were still ambivalent about the economic rationale for a new regional development bank, and were looking for convincing arguments about what the EBRD could do that the World Bank, the IMF, and the private sector could not. The proposals brought to the meeting by the French did not satisfy them; in fact, quite the contrary. While the French continued to favor a broader mandate for the bank that would include the function of policy-lending to governments in support of macroeconomic reform, the US argued vehemently and in the end successfully that the expertise in policy lending lay in Washington, at the World Bank and the IMF, and should be handled principally through those institutions. [127] This left the EBRD focused principally on project lending, with the US and several other states adamant that the new bank should support solely private sector projects. Attali and his associates, consistent with current economic philosophy and practice of the French government, maintained that ownership (public or private) was not the most important issue, even more so in CEE than in France. The issue was really about competition, and the argument was that carefully chosen investments in public sector infrastructure projects and state-owned enterprises <u>operating in competitive sectors</u> could facilitate greatly the growth of a market economy in CEE.[128] Attali's efforts to preserve maximum flexibility for the bank by avoiding any statutory limits on the types of loans the bank could make reflected that reasoning; but they were not viewed kindly by the Americans, some of whom suspected that the "true statist nature" of the bank the French had in mind was now being revealed.[129] Regarding the Soviet Union, the US was prepared to have Moscow as a member but only with shares smaller than its own and that of the large European states, with the additional caveat requiring Soviet subscriptions to be paid in hard currency. Whether the Soviet Union would

then be able to borrow from the bank was not agreed.[130] And on the issue of subscriptions for the European Community and its members, the US expressed concern about non-sovereign entities -- the Commission and the European Investment Bank -- each taking shares as charter members in an IFI.

These were more than just matters of precedent, although that was certainly important. Apart from the problem of the Soviet Union, US officials worried in particular about what they described as the "state socialist" orientation of the EIB and saw its inclusion as one more indication that the EBRD might be tending in the direction of lending philosophies they were seeking specifically to avoid.[131] With this basic discrepancy amongst the positions of the negotiators on basic conceptual issues about what the EBRD should be and do, the February meeting ended ambivalently. Most of the European participants remained enthusiastic about the project in general and hoped to bring it to fruition within a few months. The Americans were considerably less enthusiastic. The US, however, decided to stay involved in the project at this point and try to influence its direction mainly because the Europeans and particularly the French seemed singularly determined to create the EBRD, and top US officials sensed that they were ready to do so with or without the US on board.[132]

That decision appeared to pay off during the third major constitutive conference in March, as a set of important compromises emerged from what one US official called a "process of mutual education" taking place during the negotiations. That process was more than just a marginal adjustment of negotiating positions for the sake of coming to an agreement. It rested, rather, on a partial convergence of views that was evolving about the nature of the development problem in CEE, which became more clear as more and increasingly inauspicious information about the state of economies in the region emerged through the Spring of 1990.[133] In light of the data, the US and British position calling for lending solely to private

enterprise looked increasingly untenable; it seemed plain there simply would not be enough worthy projects to lend to in the short run. The French were able to argue more successfully now that the physical and institutional infrastructure prerequisites of a market economy were so deeply inadequate in CEE that sufficient private investment would not if left on its own be forthcoming. They also stressed the point that vast sectors of the CEE economies would not in fact be privatized smoothly or immediately and that the EBRD could play an important role in support of rational and effective privatization. The US argued back that the CEE countries were in the process of dismantling state controls over the economy and that outside support should not discourage in effect this trend, by propping up unnecessarily (and with even the best of intentions) inefficient state-sector or parastatal enterprises. Both positions had now developed in directions that set the stage for a critical compromise. It was agreed at this time that up to 40% of the EBRD's funds could go to the public sector to support infrastructure that would promote further private investment, while the remaining 60% would be devoted directly to support of the private sector.[134] With that basic compromise in place, the distribution of shares was largely settled, at least for the interim -- with the US, Japan, West Germany, Britain, France and Italy each claiming 8.5%.[135] The EIB and the EC together would take 6%. It was agreed that the Soviets would also take 6%, but the US pushed strongly the position that Moscow should only be permitted to borrow from the bank up to the amount it paid in in hard currency. The US also argued in favor of creating a resident board of directors that would have a powerful voice in the day to day functions of the bank, as a way of assuring that the compromises -- much more clear in spirit than in practical detail -- would be implemented as the EBRD did business.[136]

This final caveat betrayed continuing uncertainty in the US and elsewhere about precisely how the EBRD would operate, but the basic principles and rationale for the bank were now in place. The picture that emerged from the March meetings

was of a "minimalist" bank, broad in membership and circumscribed in scope. The EBRD would act in coordination with a range of aid programs aimed at Eastern Europe but would emphasize its own specificity in a number of respects. First and most important symbolically was political conditionality. While no specific criteria were yet attached to this notion, it was clear that consensus about the substance of the EBRD's political mandate went substantially beyond simply what would be necessary to provide a stable and favorable macro-economic environment for development. The private sector focus of the bank was confirmed, along with its special interest in supporting the growth of new small and medium sized enterprises (SMEs) that other sources of capital might not reach. The EBRD would also pay special attention to the environment, helping to clean up the problems of the past but more importantly promoting new environmentally sound economic activities. To carry out this ambitious agenda, the EBRD would be given a set of tools unprecedented in a single MDB for its flexibility: it would be empowered take equity positions as well as issue loans, demand sovereign guarantees or not as the situation might indicate, underwrite security offerings, and more. Finally, as its presence in both the public and private sectors of CEE economies matured, the EBRD would aspire naturally to a principal role in providing advice to governments on privatization, the reconstruction of a private financial sector of commercial banks, capital markets, and the like. In principle, the Bank now had carved out an economic and political rationale and a corresponding niche to fill within the mixture of Western aid initiatives toward CEE.

It became clear at the end of March in Washington that this rationale was one the US administration felt in general it could accept. From a political standpoint, the US supported the bank as an outward, foreign policy-oriented European initiative that would "demonstrate the political commitment of Western Europe to and solidarity with" the CEE countries and at the same time include the US in a key supportive role.[137] From an economic standpoint, a multilateral

financial institution whose primary mission would be to mobilize private capital and lend at market rates to support the growth of the private sector in preference to the state, in countries committed to the advancement of human rights, market economics, and multiparty democracy, fit comfortably with favored American ideas about the proper role of external support for development.[138] The administration's formal position was now that in principle, a new development bank for CEE could be a "very very important tool for transition" and as formulated in March the EBRD went "a long way toward fulfilling the role" that the US wished to see for it.[139] So long as the bank continued to develop in that direction, these general ideas were reinforced by more plain US interests. Senators and Administration officials agreed that the bank could be viewed as a nouveau form of burdensharing, where the US need carry only 10% of the costs (instead of the approximately 19% it carries at World Bank). The EBRD would thus "leverage" US power at a time and in a part of the world where US resources were wanting. This was not just vague geo-political reasoning: given the position of US banks and corporations in CEE relative to Germans and others, it seemed that a US commitment to EBRD would be a sensible and "good investment for US business".[140] The same was true for Britain and for many other EC states as well as non-European participants in the project, who stood to gain greater access to opportunities in CEE through partnership arrangements that could evolve at EBRD.

These arguments did not go unchallenged in Washington and elsewhere. Opponents recognized the bank's positive potential, but questioned whether basic conceptual issues had yet been addressed adequately. They doubted in particular whether the political and economic missions of EBRD would turn out to be compatible. If it were to operate more like a commercial bank than a traditional development bank, the EBRD would have to identify worthy projects, administer loans, and collect on them just as private banks do. But to avoid simply duplicating or competing with the private financial sector, the EBRD would have to focus on

projects or on sectors that the "market" ignored. The notion of lending to SMEs was admirable but the mechanics were a problem. How would the EBRD find the SME projects to lend to and how would it evaluate their credit worthiness? If it were to rely on local or national financial intermediaries to play that role it would likely run into problems at least as bad as those faced by other development banks' lending programs through development finance institutions.[141] In the end the EBRD might find itself lending primarily to large state-owned enterprises, which it would have to do very carefully lest it impede inadvertently privatization and other systemic reforms.[142] From a political standpoint, conditioning aid on democracy and human rights was an equally attractive idea but also difficult to implement. Would the EBRD be able to act consistently in this realm and with any meaningful degree of autonomy? How would it deal with a "Pinochet-type regime" or a South Korean analogue that sacrificed some measure of democracy in favor of stringent macroeconomic reform? Opponents of the bank argued generally that their states should not consider joining EBRD until these questions were addressed in more detail, because they suspected that the answers would say much about what the bank would actually turn out to be.

Opposition remained strongest in the United States. While the Bush administration seemed willing on the basis of understandings reached at the March conference to take a "watch and wait" attitude toward these larger conceptual issues, there were several specific concerns still unsettled that Mulford called potential "deal breakers".[143] The first concerned the EIB, which the US still wanted to exclude as a non-state actor but more importantly because of the sense that "its activities may not match the private sector emphasis we are seeking for the bank".[144] The precise shareholding for the US had still to be settled, and the US wanted its subscription denominated in dollars not in ECUs, the latter being the operating currency of the bank.[145] The most critical matter, and the one "that if not resolved satisfactorily may preclude [the US] joining the EBRD", was still the

status of the Soviet Union.[146] The issue was wrapped up in precedent -- the US did not want full membership in the EBRD to justify somehow a Soviet claim on equal status at the World Bank and IMF -- as well as the critical question about the Soviet place in Europe. Put simply, the US administration was not ready to concede Moscow full charter membership in the first "post cold war" European institution, for political and symbolic as well as purely economic reasons. If the Europeans insisted on this point, the administration took the position that it could walk away comfortably from EBRD and concentrate on "other options for us to expand our influence and leverage" in CEE.[147]

Spring 1990: Closing the Deal

This was in a very real sense a critical juncture for re-defining "Europe" and the place of the US and Soviet Union within it at the end of the Cold War. Treasury officials handling the EBRD negotiations made clear that the US administration was prepared to shun the bank over the Soviet issue. In their view, this would not signal a retreat from Europe per se, since the US could and would "find other bilateral and multilateral vehicles" to support our interests in CEE.[148] Mulford in particular pressed the point that in the US view, a combination of bilateral initiatives with World Bank and IMF support were together functionally sufficient to handle the challenge and that the EBRD, while potentially useful on the margins, was not a necessary addition.[149]

The US government, in other words, took the position that it was not de facto bound to participate in an institution that would have the undesired effect of

legitimating Soviet claims on full membership in Europe. On the contrary, by staying out the US could draw attention away from the EBRD and toward other fora in which Moscow had a lesser role. While Treasury Secretary Nicholas Brady conceded that the EBRD would probably go ahead without US participation he noted (correctly in my view) that its importance as a political sysmbol would have been diminished, while other countries in Europe and outside (in particular Britain, the Netherlands, and Japan) would have paid it less practical attention. None of these states threatened explicitly to drop out of the bank over the Soviet question, but each gave signals that they would take a more distant view of the EBRD if the US were not a member. The CEE countries themselves preferred US membership for obvious reasons both political and economic.[150] If the deal with the US had fallen apart at this time, the bank might have come into existence regardless but it would have carried considerably less political and symbolic significance. From an economic standpoint, bilateral state-to-state deals supplemented by World Bank and IMF programs might have been more significant and emblematic of the West's evolving relationship with CEE. The next set of meetings, scheduled for April 8-9 in Paris, would be crucial.

In anticipation of that meeting, the French proposed new statutes that went part of the way toward meeting American concerns: the bank would commit to lend no more than 20 - 25% of its total outlays to a single country under any circumstances, and would limit for several years its operations in the Soviet Union to what Moscow paid in.[151] The US balked at the leniency and perceived informality of these strictures and asked that the limit on Soviet borrowing be made more firm, with the particular provision that the restriction on Moscow's status be subject to change only with the concurrence of countries representing 85% of the shares in the bank.[152] Washington now also made clear that it wanted to be the largest single shareholder in the bank at 10%, which would reduce the share for the European countries and the EC to 51%. At the same time, the US softened

somewhat its opposition to EIB membership; but insisted that the EIB share be no greater than the smallest share of an individual country and that the EIB not be represented individually on the Board of Directors.[153]

While the positions were not final and the areas of disagreement left considerable space for wrangling over details, these compromises made clear to most of the participants in the negotiations that the most critical question -- which definition of "Europe" the EBRD would embody -- was about to be settled. The EC 12 together with the Community as an independent actor would have a majority of shares and a controlling interest in the EBRD. The US would be a member of the bank; in fact, it would be the largest single shareholder, with plain symbolic implications for Washington's special status in a new European institution. The Soviet Union would also be a member but in a restricted capacity that could be upgraded only with broad consensual approval. This conception of Europe was much closer to what the EC had originally wanted to promote within the bank than it was to the American and British "Atlanticist" or French "Europe des patries" notions, and it had essentially displaced both.[154]

The Paris Meeting reinforced this understanding by settling many of the remaining details about the bank's constitution. It was now agreed that EBRD would be capitalized at ECU 10 billion to start, with 30% paid in.[155] The US would take 10% of the shares and the Japanese 8.5%, equivalent to the 8.5% shares of the largest European countries (Germany, France, Italy, Britain).[156] The Soviet Union would be designated a "recipient country" and would take 6% of shares but would be limited to borrowing up to its own paid-in capital for a period of 3 years at least. Finally, at least 60% of the bank's aggregate annual lending and at least 60% of lending over the first five years to an individual country would be devoted to the private sector or to enterprises in the process of privatization.[157]

Mulford left Paris satisfied that in this "breakthrough meeting... all our major objections have been addressed", but US participation in the Bank was still not assured.[158] In Washington, Senators Robert Dole (R-Kansas) and Robert Kasten (R-Wisconsin) spearheaded a move by conservative republicans with some support from organized labor to oppose American participation in the bank. They raised two familiar issues: the question of Soviet participation, and the historical record of previous mdb lending programs.[159] To the extent that the EBRD attracted US media attention it was mostly negative; the New York Times editorial page mostly ignored the bank, while the Wall Street Journal came out solidly in opposition.[160] At House Subcommittee hearings on May 9, Mulford and Congressional supporters of the Bank came under fire from witnesses who criticized the supposedly different "predispositions" of the West Europeans concerning market economics and pushed the point that EBRD had not yet offered a convincing plan for how it would make loans to private sector SMEs.[161] The argument that the US somehow "had" to join the EBRD anyway, to demonstrate its non-isolationist credentials at the end of the Cold War, was attacked roundly.[162] If the EBRD was the "wrong" institution, the US would be better off holding back from it while demonstrating a commitment to Europe in other, more appropriate fora. Opponents raised three specific alternatives: the US could stress selective bilateral aid and focus its efforts on countries that make the most progress according to an "index of economic freedom" or something along those lines; it could stress markets by negotiating free trade agreements with E. European countries on a bilateral basis and challenging the EC to match the agreements; or it could stress other multilateral efforts through the World Bank and IMF, where the US maintained a stronger voice.

Nor were the EC states unanimously enthusiastic about EBRD. Britain and the Netherlands maintained concerns about how the bank would operate not very different from those of the US. In addition, the lingering questions of where the

Bank would be based and who would serve as President were particularly controversial for EC members. Those questions were answered during the second week of May as a part of a private agreeement among the G-7, but the answers caused considerable indignation among smaller EC countries who felt (not without reason) that important decisions about this supposed European institution had been made over their heads. As the G-7 decided, Attali would be the Bank's first president and the headquarters would be located in London.[163]

A "rancorous" meeting of the member nations in Paris on 20 May concluded the formal negotiations for the Bank, with a vote of 32 to 8 in favor. The signing ceremony for the charter, held just over a week later, was also somewhat fractious.[164] French President Mitterrand tried to elevate the tone of the event, expressing his belief that the EBRD would evolve into "a major world financial institution" and would serve as a model for the promotion of private entrepreneurial initiative in countries "committed to and applying the principles of multi-party democracy, pluralism, and market economics".[165] His buoyant enthusiasm was not matched by US Treasury Secretary Nicholas Brady or by others.[166] Although the EBRD had gone from conception to a completed and signed charter in an unprecedented 7 months, the birthright for this new bank was decidedly ambivalent.

The act of signing the charter did not erase that ambivalence. But it did confirm broad agreement on certain shared general goals about what the shape of the first new international institution of post Cold War Europe would be. First and foremost, the EBRD was a self-avowed political institution dedicated to the intertwining of democracy with market economies in the emerging states of CEE. This general goal was never seriously questioned during the negotiations and it was not just a least-common-denominator agreement to avoid a shared aversion. Rather, it rested on the foundations of an emerging consensus about the relationship between politics and economics in modern economies, with specific implications for

development lending, and the role of the private sector. This was a convergence among ideas that had been evolving for some time in the West but that was elaborated, expanded upon, and operationalized in the negotiations over EBRD.

Second, the bank would embody a particular definition of Europe after the Cold War, a definition that did three important things: giving privileged position to the Community per se, embracing the United States as a principal associate or partner, and including the Soviet Union, albeit in a special apprenticeship role. This general goal was not clearly shared in October of 1989 when Mitterrand first proposed the EBRD and it did not emerge entirely smoothly in the subsequent months. The French and the Americans in particular flirted with alternative conceptions of Europe but eventually converged on something close to that proffered by the European Commission. The imminent power of the re-unified German state, relatively pliant to the broad multilateral view of Europe during the negotiations over the bank, certainly cast a looming shadow in the calculations of the other major states and was one factor behind this convergence. But the EBRD as it would turn out was more than just a least-common-denominator means to dilute or balance German power in Europe.

Shared general goals made a deeper and more profound cooperative outcome viable. In the face of great uncertainty about the political and economic futures of CEE, states compromised on narrowly-defined and parochial interests in favor of creating a multilateral institution. Expectations converged around the notion that the first concrete manifestation of the new East-West relationship should be characterized not by bilateralism or by "minilateralism", an exclusive European club made up of just a few states, but by a broader multilateral form of organization. The idea of a European institution came to embody an open and expansive definition that privileged the Community and held a special partnership status for the US, as well as a new apprenticeship role for Moscow. Political conditionality and the

particular role of the private sector in promoting the development of a competitive, market economy were agreed first as concepts and then in initial details of implementation. There was still considerable space for bargaining and jockeying for position. But the political and economic rationale of EBRD put borders around the game, as it would be played out in the bank itself and in the bank's relationship to other initiatives aimed at CEE. That eased considerably the bargaining that still had to go on over methods and tactics -- how this new institution should actually carry out its task of promoting the political and economic transformation of CEE.

Problems Unsolved and Problems Solved

With a small staff temporarily headquartered in Paris, the newly constituted EBRD began seriously in the summer of 1990 to sort out the operational implications of its mandate. It started with several unique characteristics useful in defining the outlines of a niche different from other IFIs: an explicit political rationale, a concentrated regional focus on countries with relatively high indices of development, and a distinctive commitment to the private sector.[167] The EBRD could immediately claim a special role in assisting the countries of CEE to reduce generally the presence of the state in the economy as a way of reinforcing markets and, by implication, democracy as well. Finding the appropriate areas for continuing state involvement in the economy, both in the short term and the longer term, was the key to making the consensus behind the 60/40 provision meaningful.

With its prospective presence in both the public and the private sector, the EBRD also had a natural claim on a close advisory role to new governments in CEE

that would be looking to shape a macroeconomic environment conducive to private sector growth and would need help in doing that. This tapped into an important and one of the most convincing lessons of development lending during previous decades, that "good" projects in a "bad" macro environment will fail, or at a minimum will do much less well.[168] Although the World Bank and the IMF have modified substantially their practices and developed new mechanisms of coordination between them to reflect the practical implications of that learning experience, the EBRD was set up purposely and explicitly to act under one roof both as a friendly advisor on macroeconomics and a project lender, and could thus claim a special capacity in this critical area.

Rather quickly two specific and closely related areas of attention for the new bank were identified. First, the EBRD would take a special role in promoting the growth of new small and medium sized enterprises (SME), distinguishing it from the World Bank (with its emphasis on public infrastructure) and the IFC in practice, if not in principle.[169] This niche was particularly attractive to the EBRD for several additional reasons: in the short term, it promised to generate the greatest payoffs in economic activity and productivity in post- socialist economies, and it meshed nicely with the bank's commitment to democracy.[170] Second, the EBRD would be distinguished by the flexibility of its operations. This was more than just a matter of offering a full range of financing instruments (including loans, equity investments, securities underwriting, etc.); it also meant creating a "corporate culture" within the institution different from that of other IFIs, and more like that of a merchant bank. The Bank's early publications emphasized an "aggressive" image that stressed "fluid organization" and speed of response, a willingness to take risks, and a "client-driven" orientation which would make the bank "the partner of choice for the private sector".[171]

These ambitions raised organizational issues about the bank that caused new

quarrels during the first post-signature conference of the participating states in July. Bank management sought at this meeting to maximize flexibility and discretion by concentrating decision making power in the hands of the President and his staff, at the expense of the board of directors. The Bank circulated draft by-laws which proposed not only that "the President may take all steps which in his or her opinion are necessary to conduct the current business of the bank" but also that the plan to appoint a resident board of directors be simply deferred for two years.[172] This shocked in particular the Americans, who made clear their understanding that the basis of authority went the other way around. In their view, the management was charged with carrying out the preferences of the board, which should have from the beginning a central role in setting operational policies for the bank.[173] This reflected in part lingering concerns about the bank management's economic philosophy and questions about how strong its commitment to the private over the state sector would be in practice. It also reflected, more generally, some straightforward consequences of building and operating international institutions in a non-hegemonic world. States of relatively equal power that had compromised to create the EBRD would want to insure that it continued to serve generally their interests -- interests represented in practice by the board of directors. The first two years were most critical, since that was the time in which policies and directions for the Bank -- difficult to reverse later -- would in effect be established. The logic of the situation was not lost on bank officials. At the next shareholders meeting in October, Attali acquiesced to the immediate appointment of directors and re-affirmed understandings that the EBRD would have four or five vice-presidents, one of whom would be an American and one of who would come from Eastern Europe.[174]

By the Fall of 1990 the EBRD was seeking out possible clients in anticipation of making its first loans the following Spring. An informational release aimed at private sector institutions in September specified priority interests in small

and medium sized enterprises and in catalyzing foreign capital to "complement investment financed out of domestic savings" aimed at projects that would be "efficient and competitive". The EBRD described itself as "unlike... the World Bank or IFC which cover hundreds of countries all over the world needing the most basic aid for infrastructure and economic development"; instead, "the EBRD will concentrate on a limited region of countries already having in place infrastructures and developed economies."[175] With this optimistic assessment the Bank seemed to be positioning itself between assumed enthusiastic sources of capital in the West interested in seeking out new opportunities, and CEE entrepreneurs with good ideas and nascent bankable projects who were starving for capital. The basic argument behind this strategy was still focused on market failure: lack of information, excessive transaction costs, lenders' economically unjustified fears of moving into a new part of the world, etc. as the principal obstacles to growth and redevelopment in CEE. If that were in fact the case, the EBRD's principal role would be to "identify investment opportunities and assist in bringing together the capital, management, and technology necessary" to capitalize on good opportunities that private investors could not or would not have taken on their own.

This was not a panglossian view of the situation in Eastern Europe; it reflected simply a confidence that there were sufficient bankable projects in CEE particularly among SMEs that the EBRD could focus its energies most productively on efforts to reduce market failure. There was still, however, a practical puzzle: what advantage did the London (or at this time, still Paris-based) bank office have in identifying attractive private sector projects in the East? How would it evaluate and administer loans to small enterprises -- for reasons of efficiency the EBRD could not deal directly with SME but who or what would serve as the intermediary? Could the bank claim credibly a special ability to find and energize opportunities that investment banks from Western countries could not?

The combined experiences of IFIs' efforts to play a comparable role in other parts of the world were not encouraging. The World Bank "directed credit" program, which relied mostly on state-owned development finance institutions to act as intermediaries and on- lend World Bank funds to private entrepreneurs, had achieved at best a "mixed" record and had a high percentage of loans in arrears. The EIB's "global loan" program offered a somewhat better record but it was achieved in part by sacrificing initiative, since these loans are made available only to projects already identified by private actors and supported with at least 50% of needed capital from elsewhere. EBRD officials, arguing that development finance institutions mostly failed as financial intermediaries because they lack the human resources necessary to evaluate SME borrowing requests, raised the possibility of the bank opening its own branch offices in CEE but ran into opposition from the Americans and other shareholders who worried about branches skimming off the better borrowers and undermining the development of a private commercial banking sector there.[176] This dispute over methods threatened to leave the EBRD hobbled in its own niche. The requirement that 60% of its lending be directed to private sector or privatizing enterprises along with the special commitment to SME risked low hurdle rates for loans and problems with absorptive capacity that could, at least initially, make the bank look unproductive or superfluous.[177]

This too was not lost on EBRD personnel or on critics of the bank. If the EBRD could not do more than existing international financial institutions there was good reason to ask again why it was there, particularly as the World Bank and the IFC had already announced plans to expand their lending and advisory operations in CEE.[178] This did not necessarily crowd out the EBRD; in fact, a World Bank Senior Vice President acknowledged his organization's intention to play a "progressively smaller role" in CEE as the EBRD matured.[179] Still, the relationship between these institutions remained unsettled. Although all three could presumably be involved in co-financing, it was also evident that there could be

competition to identify bankable projects. The institutions also had very different political mandates; it was not clear for example what would happen to World Bank loans in practice if a state were to be cut off from the EBRD for "backsliding" on democratic reforms.[180] Vague statements on these questions from all sides generally made it look as if each institution saw the other as a source of support and supplementary funds for its own preferred programs.[181] One place where the EBRD might claim special status was in its position vis-a-vis the Soviet Union since Moscow was not yet a member of the World Bank; but the EBRD's potential for a distinctive role here was limited by the severe restrictions on the bank's freedom to lend to Moscow.[182] Overall, the rationale for the EBRD and its presumed special niche appeared to be losing not gaining security in the first few months of planning for the bank's operation after its charter was signed.

A Modified Focus

The EBRD responded to this threat by updating and revising some of the banking notions that had developed over the course of 1990, to take account of evolving assessments of the scope of the problem of economic reform in CEE. This shifted the bank's operational priorities somewhat but at the same time strengthened the bank's niche among the various aid initiatives. That niche had two important features: it was not redundant to what other institutions and individual states were doing; and it offered net gains for the Western members as a whole, in ways that tended to reduce positional concerns among them. The EBRD with its modified focus stood for these reasons to reinforce the convergence on broader goals that had led to the bank's creation in the first place.

As 1990 came to a close, bankers from the EBRD (and elsewhere) found the market failure explanation for the scarcity of diverse private investment heading into CEE less and less powerful. The three states most familiar to Western capital investors -- Poland, Hungary, and Czechoslovakia -- had initiated major steps toward transforming their economies, that included macroeconomic stabilization measures, substantial price reforms, significant opening to international trade, and revisions of legal frameworks to allow many forms of private ownership. The magnitude and the consistency of reform measures varied greatly across the region as well as within single countries but one fact was constant: results were discouraging.[183] Even where markets and investment regimes were liberalized substantially, payoffs in foreign investment were being hampered by a shortage of high-quality projects and by an almost complete lack of effective local financial institutions positioned to identify and take advantage of less obvious but possibly emerging opportunities. With CEE falling into a massive recession (Poland's official measure of output fell 14 % and Hungary's 6.5 % in 1990), it was becoming clear that foreign investors were not sending funds to the region in anything like the amounts that had been hoped for a few months earlier.[184]

This was not for lack of interest. Representatives from Western banks and Western corporations continued to scout intently throughout CEE for attractive opportunities, but were finding them to be few and far between. By the end of 1990 virtually all major companies in Europe and many based in the US and Japan had teams dedicated to the effort; but in a survey of 54 large (Fortune 500) firms researchers from the Institute of International Finance found that less than 40% had made investments in CEE and that most of the projects were quite small, accounting for less than 1% of the firms' total foreign investment.[185] As of October 1990 there were only about 7000 foreign investment registrations in the region valued at a total ECU 4.5 billion, and less than 30% of these enterprises were actually

operating.[186] Investment was concentrated in sectors promising high short term returns or assured hard currency cash flows, such as media, hotel, and energy/raw materials.[187] Prospects for the forseeable future were not very much brighter: while an additional 30% of the polled firms anticipated making investments in CEE within 5 years most expected to be involved only in small projects so that overall private investments were expected to do no more than double.[188]

It was becoming painfully obvious that to increase the stream of FDI into the region would require a great deal more basic spade work than had been anticipated early on in the transition. That extended beyond physical infrastructure, to an infrastructure of basic financial institutions that could act as conduits for investments in deserving projects that large Western firms would not find or could not administer on their own. In a sense, this exacerbated further the dilemma of the EBRD since it was bound to do 60% of its business in a private sector that was not yet vibrant, not full of budding and bankable SME projects, and most importantly not yet readily accesible via local financial intermediaries. When the EBRD shareholders met in London between January 28th and 30th 1991 this tension between what the bank had been positioning itself to do and the apparent needs of CEE was brought out into the open, most poignantly by the East Europeans themselves.[189] But the Bank had already moved to shift its niche in subtle but important ways.

The new rationale offered by Bank personnel was that three critical pillars of a modern economy -- communications, energy, and finance -- were missing or weak in CEE and should be the focus of the EBRD's activities in the immediate future. These sectors were not specific in any sense to the EBRD but did offer targets where the new bank could stake out special competence and distinguish itself from what other IFIs were likely to contribute.[190] The financial sector was particularly promising, for its obvious relationship to what the EBRD had set out to do at the

start in support of private enterprise and particularly SME. If the Bank could position itself to provide expertise, funding, and logistical support for the development of a vibrant sector of local banks and other financial intermediaries it would have marked out a new niche consistent with its broad goals but more immediately practical. Support for the financial sector would take the form of technical assistance and training programs for bankers from the countries of operation, support for privatization of existing banks, and investment in "Central Europe Agency Credit Lines" that would twin Western banks with local commercial banks as partners in developing lending programs aimed specifically at SMEs. By Spring 1992 the EBRD had developed two such deals with large Europe-based investment banks, each of which would be responsible for providing at least one-half the capital and for administering loans under guidelines mutually agreed between local affiliates, the Western partner, and the EBRD. With a minimum loan amount of 250,000 US dollars, this program had substantially more potential to reach SMEs than did the EBRD's direct lending procedures, where the minimum practical loan approached 5 million dollars. The goal was to catalyze over time the development of a network of small, autonomous financial institutions with the necessary human resources and expertise, to "create the conditions under which small entreprenaurs can thrive".[191]

The EBRD could play a similarly important role in the communication, energy, and transport sectors while distinguishing itself from the World Bank in several ways. First, the EBRD would try to develop close advisory relationships with governments in the region and stress technical assistance for policy-making. In that capacity, the EBRD would be positioned to support the development of strategies for infrastructure investment that would balance carefully between projects aimed at <u>international</u> linkages that would serve the integration of the region with Western Europe, and projects aimed primarily at <u>domestic</u> transport and telecommunication needs. The EBRD would also distinguish itself by stressing

wherever possible in infrastructure projects a private sector component, through innovative partnership deals between governments and private investors to fund and operate infrastructures on a long term contractual basis in B-O-T and other concession schemes.[192] Finally, it would take a special interest in projects related to the environment and try to be a leader in promoting infrastructure aimed at long term "sustainable growth" in the region.

These missions taken together illustrate how, by the time of its inauguration in April 1991, the Bank had shifted effectively its operational rationale toward more practical tasks. With a combined emphasis on advancing the development of physical and other infrastructures supportive of a market economy and particularly the financial sector, and supporting directly the private sector where practical, the EBRD looked increasingly like an important and non-redundant part of a balanced and integrated development initiative for CEE. In revising its economic rationale toward more practical short and medium term goals, the Bank was able to develop a substantial presence in several sectors and particularly in telecommunications, where the EBRD committed nearly $350 million in new loans over the course of 1991.[193]

This reorientation of the bank's focus was driven mostly by pragmatic assessments of the immediate needs of the region as well as of the comparative advantage of EBRD in relation to other IFIs, but it also had the effect of reinforcing convergence among the Western states on the political-economic rationale that had emerged through the negotiations leading up to the bank's founding. This was evident particularly in the expansion of the basis of US support for the bank. As it became more clear that American corporations and banks would not by themselves adopt an aggressive, forward looking business stance toward CEE and might even be pre-emptively excluded from emerging opportunities there, it also became obvious that the US stood to benefit disproportionately from what the EBRD was now preparing itself to do. The political logic of the US having special status in a

"European" institution also promised concrete payoffs for American interests. To the extent that the EBRD would be involved in pressuring the Commission and governments in Western Europe to open the EC market to CEE exports and particularly to agricultural goods, the bank would be making common cause with American complaints about the Community's common agricultural policy. The US could also through its place in the Bank exercise a legitimate voice in negotiations over supposed "European" issues like the re- organization of intra-continent air routes and the proposed European energy charter.[194] More broadly, the EBRD had come to espouse a set of ideas about development strategies and development assistance which fit comfortably, if not perfectly, with what the US government had been pushing on other MDBs for some time. For all its possible flaws, the new bank had put together a rationale and a work plan for development aid that went beyond what the US was able to achieve through pressure on the World Bank (where it had more nominal voting power and influence) and at other MDBs. The EBRD, from Washington's perspective, could very well become a prototype for the modern philosophy of development lending and an example to which other MDBs would be compared.[195]

The Soviet and Ex-Soviet Issue

Where the status of the EBRD's mandate vis-a-vis its member states is much more ambiguous is in the bank's attempt to find its place in the Soviet Union and the successor states. Before the abortive summer 1991 coup and even for some time thereafter, there was substantially less consensus among the powerful Western states about their interests in aiding

the Soviet Union as compared to CEE, and this divergence of interests was reflected at EBRD. The US in particular distinguished between CEE and the Soviet Union from early on, and maintained that any aid to the Soviet Union should be handled principally through inter-governmental coordination and the G-7, rather than through European or broader multilateral institutions.[196] There were two basic reasons behind this insistence. The first was that Washington was determined, as leader of the Western alliance, not to cede its priviledged position in the formation of policy toward Moscow. The second was a strong sense at least prior to summer 1991 that there existed a substantial difference of views between the US and some of its West European allies over the proper course to take with regard to the post-communist Soviet Union and then its successor states.[197]

That sense was well justified. From early on the Western states shared downside concerns, about the possible effects on their national budgets and on world capital markets that would follow from massive infusions of aid to the Soviet economy. They also largely shared a downside view of what could happen if reform in the Soviet Union were to turn terribly sour -- and it was agreed that the consequences could be far more negative than was the case for CEE.[198] Beyond that point views differed sharply, in ways that reflected particular conceptions of interests that were not shared. In 1990, the French government and the Commission largely agreed on the basic principle that the West should extend a "helping hand" to the Soviet Union and act pre-emptively to support reform there with substantial aid.[199] The German government expressed general sympathy for this view but had its own particular reasons to support aid even more vigorously. Apart from the still operative geopolitical logic of Ostpolitik, Kohl's government had agreed de facto to purchase with D-marks Moscow's blessings for re- unification and the adherence of the new German state to

NATO. The price was not cheap and it served clearly Bonn's interest to get others to share some of the burdens.

The US was steadfastly opposed, in part for financial reasons but also because the administration was not yet convinced of the political rationale for sending money to its erstwhile Cold War adversary.[200] The US (with some suppport from Britain) also pushed the point that Gorbachev's government had still to demonstrate its ability or even a consistent willingness to bring about the kinds of legal and macroeconomic reforms that could make outside aid useful, and that until that happened money put into the Soviet economy was money wasted. The EBRD charter of May 1990, which brought the Soviet Union into the Bank as a recipient state but saddled it with a stringent limit on borrowing, was a compromise between these interests that respected also Washington's concern about setting a precedent for full Soviet membership in other IFIs. It was not, however, a compromise that reflected the seeds of a convergence of interests and it was not a deal that the Bank's operations could effectively reinforce.

That became clear within a few weeks after the charter was signed, as the German and French governments forced the Soviet aid issue right back to the fore.[201] Germany on 21 June granted on extremely favorable terms an almost $3 billion guaranteed loan to the Soviet Union, the single largest credit Moscow had yet received from Western banks.[202] At the "2+4" talks on German re-unification just then getting underway in Berlin, Kohl and Mitterrand issued a joint plea for other Western states to join in this aid initiative.[203] At a summit of EC heads of state in Dublin a few days later Mitterrand raised the stakes further by calling on the West to commit as much as $15 billion to the Soviet Union, and arguing that the EBRD should be put in charge of coordinating that aid.[204] Neither proposal was

immediately accepted, but the EC did agree to begin a study of the Soviet economy with the aim of generating more specific aid plans to be decided at the Rome summit scheduled for October.

With a G-7 summit at which the Soviet aid question was set to take center stage pending in early July, the US responded cautiously to events in Dublin. On 2 July President Bush set out the US position: the US would provide limited humanitarian and technical assistance but would not yet offer financial aid (balance of payments support, currency stabilization support, etc.) to the Soviet Union. Bush also agreed to consider granting Moscow a special "associate status" at the IMF and World Bank, which would facilitate technical assistance and advice but not permit lending. This offered some minor concessions to the continental Europeans' sensibilities but also showed that the US administration's basic conceptions of interest on Soviet aid had not changed. The best possible outcome was a cordial agreement to disagree -- precisely what was achieved at the summit in Houston, where the G-7 endorsed what it called a "complementary approach" to Soviet aid which meant basically that each member could take its own course vis-a-vis Moscow and provide whatever financing it favored, without substantial coordination.[205] Hoping to increase the base of consensus for future cooperation, the G-7 also agreed to initiate its own comprehensive study of the Soviet economy, to be conducted by a consortium of the IMF, the World Bank, the OECD, and the EBRD.[206]

Although the EBRD was only one of four institutions charged with carrying out this study, its inclusion in that group at all was significant. The constraints in its charter on lending to Moscow notwithstanding, the Soviet Union was clearly the "big prize" for the EBRD. From purely an economic standpoint, the Soviet Union offered and its successor states continue to offer

to the Bank its biggest challenge but also its biggest potential payoff. Importantly, the other IFIs are not priviledged by dint of experience in the Soviet Union (as they were in at least some CEE states); here the EBRD was starting on equal ground. In political terms the prize for EBRD was at least as large -- supporting the extension of multiparty democracy, pluralism, and respect for human rights into the vast political space that was the Soviet Union was a massively significant mandate whose promise could not possibly be ignored by the new institution, even in the face of the enormous obstacles. With these kinds of prizes in sight and with the de facto contraction of the Bank's mandate in CEE it was not at all surprising that the EBRD should immediately strain against the limits imposed on its Soviet operations.

Those strains became increasingly public not long after the bank was inaugurated in April. In June 1991 Mr. Attali made a heavily pulicized trip to Moscow to discuss with Gorbachev an EBRD plan for Soviet economic reform. While in Moscow, Attali announced publicly his already well-known desire that the EBRD shareholders rescind the restrictions on bank operations in the Soviet Union.[207] In a bold move, he also issued an invitation to Gorbachev to visit EBRD headquarters in London for discussions about the Soviet economy. That invitation came before the G-7 had decided finally whether to hear Gorbachev in person at their annual summit, scheduled for mid-July in London, and it caused considerable consternation in Washington and other capitals as well as at the EBRD board of directors.[208] When Gorbachev did come to London to make his plea, the EBRD restrictions were again on the agenda, with both Mitterrand and Canadian Prime Minister Mulroney in advance of the summit offering proposals to modify them.[209] In one sense, a decision to ease the EBRD restrictions might have been seen as a small, low-cost (and thus attractive)

"carrot" to grant Gorbachev once it became clear that he was not going to get very much more from the G-7, but the US along with the Japanese stood firmly against any changes in Moscow's status at the Bank. Instead, the G-7 agreed to grant to the Soviet Union special associate status at the IMF and World Bank as well as other small benefits, in anticipation of Moscow committing in the near future to a substantial and comprehensive reform plan.

The August coup and subsequent developments changed the nature of the problem and have substantially eased the tensions between Western states over the Soviet and now post-Soviet states, but it is still worth speculating about whether the dissension over Soviet status could have undermined the consensual political foundations of EBRD, had the events of August not occured. I think it is not likely. Even prior to the coup, the positions of Germany, France, the US, Britain and others on conceptual issues of Soviet aid were inching closer together, even if the arguments about "burden-sharing" were no less shrill. It is notable that supporters of the initiative to modify the EBRD's restrictions in summer 1991 were _not_ now arguing that Gorbachev's policies, extended in the famous twenty three page letter to the G-7 and his presentation at London, made up even the embryo of an adequate reform plan that the West should rush to support with an infusion of massive long term aid; the effort to lift the cap was intended mostly as a vote of confidence in Gorbachev and his ability to produce and implement eventually such a plan.[210]

And if the restrictions had been lifted at this time it is unlikely that the EBRD would have done a great deal more business in the short run in the Soviet Union. The Bank's 1991 operations in the Soviet Union were concentrated heavily in the area of technical assistance for privatization

programs and commercial education as well as economic sector studies, and that would have most likely continued although a few more projects might have been funded.[211] The G-7 decision to offer Moscow associate status at the World Bank and IMF, which Gorbachev's government soon took a step further by applying for full membership, would in any event have diminished the EBRD's special status as the sole interface between Moscow and the IFIs. I suspect that there would have been some tension as the US undoubtably would have continued to push for the bulk of Soviet operations to be handled at the BWI and the EBRD would have pushed back, but it seems likely that there would have developed a division of labor between these institutions, that might have been more heavily weighted toward the BWI than the comparable division of labor in CEE. The compromise result would have respected Washington's economic and political concerns about aid, while retaining the attempt as manifested in EBRD to sway the Soviet Union slowly closer toward being part of Europe as it was defined at the Bank.

As it was, the EBRD did benefit from a lucky turn of events following the Moscow coup. In autumn 1991 the now fully independent Baltic states were bought into the Bank as new members and assigned previously un-allocated shares, reflecting wide consensus among the Western states after the failed coup that the Baltics deserved quick recognition and immediate treatment as aspiring members of the evolving European political economy. When the Soviet Union was itself dissolved at the end of 1991 the Bank moved quickly to re-evaluate its position vis-a-vis the remaining republics. From a legal perspective, Bank officials argued that the newly independent republics could join the EBRD simply by expressing their desire to do so and agreeing to adhere to the charter, by virtue of the fact that they had already been members as part of the Soviet Union. At the same time it

was argued that the former limit on lending to the Soviet Union no longer applied, since the state that had been the object of the restrictions had ceased to exist. The legal merits of this position notwithstanding, there were serious and possibly divisive political concerns surrounding these points that had not existed for the Baltic states and could not be solved simply through legal argumentation.

Two issues were paramount. Could the ex-republics of the Soviet Union commit realistically to the terms of the EBRD charter -- both political and economic -- and thus claim to aspire to be a part of Europe as it was being defined at the Bank? And how could the EBRD ration effectively its limited financial and human resources, so that the 12 successor states would not dominate the bank's efforts and leave the CEE states, for whose support the bank had been intended in the first place, in the lurch? There was a perception of real danger here, that the EBRD could become a very different kind of place and more like a traditional development bank, should it spread its wings too widely and to areas that did not in some cases even yet aspire to meet the standards of political and economic reform that differentiated the Bank from other institutions. While it was possible to argue that these concerns were less applicable to Ukraine and to Russia, some of the other republics on the western side of what had been the Soviet Union -- while closer geographically to Europe -- could not claim credibly a commitment to the Bank's economic and even more so its political conditions. The republics of Central Asia, lacking the advantages of geography as well, were in an even more tenuous position vis-a-vis the Bank.

Yet a decision was made to try to bring these states on board the EBRD, for much the same reasons that they would quickly be accepted into the CSCE.[212] This reflected a simple geo-political rationale shared by

Western states, about the possible negative consequences of "abandoning" what had been Soviet Central Asia to other forces that might come to be primary and exclusionary political and economic influences in these vulnerable republics. Although religion has only recently become an important political factor in most of these states, the issue of islamic fundamentalism became in part a codeword for the very real and much more immediate threat of competition for influence in this part of the world developing between Iran, Saudi Arabia, Turkey, and Pakistan. Confronting this was the traditional logic of positional concerns as the Western states looked out to the future: while the range of opportunities for immediate economic gain in Central Asia appeared limited, no one wanted to be exluded from the possibility of access in the future should that situation change.[213] But these positional concerns engaged the Western states as a bloc against other potential blocs, while positional concerns among the Western states were diminished by the long term nature of Central Asia's promise and the immediate availability of other opportunities closer to home. Hence a shared interest in keeping Central Asia open to the West, without substantial conflict over who would be the short or even medium term beneficiary of that openness.

In that context membership for these republics in the EBRD made good political and economic sense from the perspective of almost all the Bank's major member states. In April 1992 the Board of Governors agreed in principle to management's proposal, to grant the republics membership through a negotiated division of the former Soviet Union's shares, although the Board reserved the right to approve in each individual case final accession to membership.[214] At the same time member states set a revised limit to how much money could be allocated to activities in this area, requiring that at least 60 per cent of the bank's financial commitments had

each year until the end of 1994 to be made in the CEE and Baltic states while no more than 40 per cent could be made in the ex-Soviet republics. The EBRD looks set to expand its technical assistance programs and to a lesser degree its project financing in this region during 1992, but barring any major departure from its current orientation it appears unlikely to reach the upper end of the 40% limit during the year or any time soon.[215]

In sum, a niche for the EBRD in the successor states to the Soviet Union is emerging, if largely by dint of peculiar circumstances following the attempted coup. The most immediate issues -- humanitarian assistance, emergency food aid, balance of payments support, and currency stabilization -- do not engage directly the EBRD and are mostly being handled through bilateral channels, the G-7, and the BWI. Over a slightly longer time span, where there is substantial macroeconomic reform and the potential for project lending expands, the EBRD could come to play a significant role in the evolving market economies of at least some of the successor states. Through technical assistance programs and selective investments in infrastructure it could, at minimal expense to member states individually, help to maintain a Western economic and political presence in others. Restrictions of a purely economic nature will remain, either de jure or de facto, to preserve the capital and credit rating of the Bank -- and although there will naturally be some cost to the CEE countries in terms of the degree of attention paid to them at EBRD that cost may not be excessive. With its modified focus, the EBRD is now positioned to operate in the successor states as well in ways that will on balance reinforce its consensual mandate among the major Western member states.

V. Conclusion

Two kinds of abstract stories can be told about international institutions in the early days of post cold war Europe. The first tells of autonomous states' interests defined independently and pursued, for the time being, within institutions. This story has variants, but each puts the stress on states and on their interests conceived classically through a realist lens, and thus on power. Institutions are at most a forum, for reducing transaction costs in deals cut between those lines of power and interest.

The second is about convergence among states on a broad set of ideas and purposes that help to define interests differently. This story has variants as well, which stress instead of power ideas as an independent and primary source of states' interests, which do not then conform to realist lines. Some variants see international institutions as playing an important causal role, either in bringing about or in reinforcing convergence on ideas.

The founding of EBRD does not falsify the first story nor does it confirm the second, and it has not been my purpose to try to "prove" either story or any variant -- simply because the data that might do that lie years in the future. What I have tried to do is to sharpen the border of these two stories in the context of the EBRD, and derive sets of expectations from them without priviledging ex ante one over the other. At the same time, I used the first story as a baseline measure because the precise expectations that follow from it are easier to define.[216]

The baseline is quite simple. In 1989, the future of CEE emerges as a question for the Western states, which have suddenly to re-evaluate the terms of

their relationships to the East. Rather quickly, the Western allies agree in general terms about the nature of the problem they face and about the possible downside costs should transitions to market economies and democratic political systems fail. But the "problem", even in its generally shared definition, does not define a single solution or a single institutional form through which a solution could or should be pursued. Because the outlines of the "shared aversion" are diffuse and solutions unclear, the Western states do not agree initially that cooperation of any particular kind is necessary.[217]

In that context, states offered alternative plans for action, matched with particular institutional forms that would have allocated differently the costs and benefits. No single state was sufficiently powerful to define unilaterally what needed to be done and to either provide a collective good or coerce others into helping with provision. It is not hard to foresee what might have happened next. Arguments over what should be done, who should pay how much, and who should hold power over important decisions might have undermined efforts to cooperate and states might have gone their own individual ways according to unilateral definitions of interest. Alternatively, there might have been agreement of a least-common-denominator sort, leading to a bland international institution that would function mostly as a cosmetic overlay for unilateral action.

What probably should <u>not</u> have happened is agreement on a new international institution that extends cooperation further, in ways and in areas not previously seen. The origins of the EBRD thus suggest a different story, where convergence on a broad set of ideas and purposes help define the interests of states in ways that are separate from power. Negotiations to create the bank did more than just identify a least common denominator. They tapped into several streams of ideas -- about economic and political conditions for successful development, and about the shape and character of future Europe -- that the major Western states were

debating before 1989. Creating the bank propelled forward a process of convergence about those ideas. For better or for worse, the fruits of that process are now effectively "institutionalized" at EBRD. In a presumptive sense, a new basis for multilateral cooperation has been defined -- a basis that does not rest primarily on power.

Stronger tests of that foundation lie in the future, as the bank puts further into practice the consequences of those ideas and in so doing affects more deeply the cost/benefit and win/loss calculations of its member states. I argued that continued cooperation depends upon reinforcement of the consensus on ideas that has modified for the time being the baseline picture. Some reinforcement of that foundation has already taken place, in part because of intellectual entreprenaurship by the EBRD itself. In developing strategies to promote the growth of the private sector in CEE the EBRD helped to clarify the character and scope of basic deficiencies in the transition economies, and then moved to carve out operating niches that other institutions and individual states through bilateral programs were less suited to fill. Shared lessons about tactics, about how the EBRD would actually operate in support of its goals, emerged in the process of negotiating the bank's charter and beginning to do business. Many of these lessons concerned practical means of facilitating private investment aimed at the private sector (particularly toward SMEs) and the critical role of non-traditional infrastructure, particularly effective financial intermediaries. The EBRD has also been the beneficiary of chance events, particularly in what was the Soviet Union, that have changed the nature or at least reduced the salience of areas where consensus, weak if it existed at all when the Bank's charter was signed, might have been difficult or impossible to reinforce.

Within its first year of operations the EBRD has shown that it is not an inconsequential actor. Through March 1992 the Bank comitted ECU 621 million ($765.3 million) to 20 projects (5 equity investments and 15 loans), catalyzing a

total investment in those projects of over ECU 2.1 billion. More than half of these projects involved private sector or privatizing enterprises and nearly all were joined by foreign industrial partners or other foreign investors. Several involved foreign private banks in "agency credit lines", that would set up joint ventures with local financial intermediaries in the countries of operations to facilitate lending of small bundles of money to SMEs.[218] The Bank also conducted a large number of technical assistance projects, ranging from sector and project feasibility studies to colloquia on legal reform and enviromental law, as well as training programs for bankers and accountants.

Not all the EBRD's conceptual problems have been resolved, by any means. There has yet to be a failed loan or, more interestingly, sufficient backsliding on the part of a recipient state from the Bank's political conditions, that might raise the issue of the Bank taking substantial punitive action. The EBRD's resources still look woefully inadequate to meet the needs of even CEE, much less the successor states to the Soviet Union (but this is a problem shared by all the other IFIs and their member states, even in combination). There has been some grumbling in Germany, that the EBRD has tended to exclude preferentially German influence.[219] And there remains a danger that the EBRD could dilute its special mandate by involving itself too quickly and too deeply in some of the ex-Soviet republics.[220] Still, most observers agree that the Bank has achieved a great deal in a short period of time and established its credibility with the international financial community and with the states that agreed to create it in the first place.[221] The separate interests of those states have not gone away, but the foundation of ideas that brought those interests closer together in the Bank's founding have been reinforced.

Ideas and Institutions

The origins of the EBRD lie in a set of compromises agreed upon by a small group of powerful actors in the spring of 1990. This raises two questions: why compromise at all and why one particular compromise not others? It is possible to concoct imaginative power-based arguments that are roughly consistent with the answers to both but those arguments would be frail in at least three ways. The EBRD does not look like the least common denominator product of shared aversion. In any event, too many other possible outcomes that did not happen could fit that description, and some of them at least would fit more comfortably. The process that led to EBRD does not demonstrate the exercise of power in a decisive way -- least of all by the US -- and it does not demonstrate the simple perpetuation of extant forms of cooperation that were products of power.

What that process does demonstrate is convergence on a set of ideas. That convergence was not in place in 1989; even at the most general level some ideas were contested from the start. The French, the EC, and the US started with different arguments about how the character and scope of Europe should be defined at the end of the Cold War. Although they were closer to a consensus on general ideas about economic development and the role of external assistance, there was room here as well for the states to draw different lessons from experience and they did. Negotiating and beginning to operate the bank brought both sets of ideas closer together, as negotiators and bank personnel generated a new set of shared ideas at a more specific level, concerning the methods and tactics of how the EBRD should operate. That required intellectual entreprenaurship and political savvy as well as a permissive environment for both to operate within. It has not been entirely smooth sailing for the Bank even in that environment, since part of what has been learned are the limitations on what the EBRD with its special mandate can in fact achieve,

The foundation for cooperation may not be as broad and all-encompassing as was suggested by the rhetoric of 1990, but the smaller foundation that has emerged in its place is more realistic and has so far been made more sturdy by what the bank has become.

Consider the place of EBRD in the issue of defining Europe, and particularly the European-American relationship, at the start of the 1990s. The principal institutional manifestation of both during most of the Cold War, NATO, is now beginning a series of progressive reforms and re-orientations all of which will serve to reduce the pre-eminence and the presence of the US in the security of Europe.[222] "Atlanticism" and "multilateralism" as defined and put into practice within NATO are fading into history along with the institution, at least as we knew it.[223] The terms of the US-European relationship are in the midst of being recast. In the stark realist vision of a multipolar world, this would naturally come down to a network of bilateral ties between individual states each of which defines independently its interests. But for the moment at least few if any leaders on either side of the Atlantic express any desire for bilateralism or hold deeply any expectations that other states will act in that way.

What ideas and institutional structures now exist as possible forums for redefining the terms of the relationship? US Secretary of State Baker offers a "new Atlanticism", whose principle feature is outward-looking partnership, a foreign policy pseudo-alliance between like minded states that share conceptions of interest outside their own borders.[224] The EBRD is one place where that idea can and is being put into practice. It will not be the only place and the relationship that evolves at EBRD will be more limited in scope than Baker's grand vision suggests. But as one of the first institutions of post cold war Europe, the EBRD has taken on a critical external task and brought together for the purpose of acting on that task the relevant states, within a structure that reflects an updated vision of what Europe is.

The achievement of legitimacy for that structure and for that vision rests not so much on a "clarified" and "realistic" account of power relationships as the realist account would have it but more so on the continuing shared ideas and consequent interests of the states that make it up.[225]

Consider also the linkage between market economics and domestic political progress in target states as it is being defined at EBRD. The Bank's charter manifests a concept of conditionality different in kind from that practiced by the World Bank and IMF in the 1980s. Areas that were covered by BWI conditionality, in particular reducing government intervention and the role of the state in the economy through macroeconomic and other reforms, have been recognized explicitly at the EBRD as a distinctly political agenda. One important consequence of is that the EBRD has been forced to spell out more precisely the terms of linkage between economics and politics, in moderately formal criteria. Under what specific circumstances might a state be labelled a "backslider" for its politics and excluded from the benefits of the Bank?

In late May 1991 the EBRD Board of Directors approved a document which goes part of the way toward answering that question.[226] There are two central points. The first is that in signing and ratifying the Agreement to establish the bank and in subscribing to shares member countries (including countries of operations) committed themselves legally to the purposes of the bank as stated in article 1: promotion of multiparty democracy, pluralism, and market economics. The second point is about what those words exclude.

Here the EBRD expresses sympathy for but finally separates itself from documents like the European Convention on Human Rights, the Helsinki Final Act, or the Nov. 1990 CSCE Charter of Paris. "Human rights" as defined broadly within those documents are important but they are not an essential part of the EBRD

mandate.[227] When evaluating a state's progress the EBRD will take into account "only those rights which, in accordance with international standards, are essential elements of multiparty democracy, pluralism, and market economics". This leaves plenty of room for ambiguity but what is not ambiguous is that civil and political rights take precedence. The bank might very well try to do things to promote the extension of other, broader rights but assessments of states' compliance with the agreement will not turn on that issue.[228] This is a still a general architecture which unfortunately may get tested in the forseeable future; but when it gets tested the debate will already be bounded by a substantial consensus about what is important, and what are the limitations of trying to work through international institutions and specifically a bank to promote the development of liberal democratic states. This is an important part of the foundation for continued cooperation.

A Note on Institutions and Explanation

I argued in this paper that what happened at EBRD was not a product of functional necessity or primarily of power. It was instead the product of ideas and specifically of a consensus that was historically contingent. That consensus drew from streams of ideas that were converging to some degree before 1989. Those ideas bounded the range of perceived outcomes for the major actors, mitigated the perceived distributional consequences of institutions, and eased the process of bargaining. They made cooperation of a certain sort easier but did not make it easy. The institutionalization of these ideas at EBRD depended also upon intellectual entreprenaurship and the timing of chance events. The EBRD may survive by reinforcing the convergence of interests that was its birthright and thus

come to be an important force in setting the effective terms for the interface between politics and economics, and for relations with the former superpowers, in the new Europe. It may not, and I have tried not to go further than the current evidence allows in stressing what the EBRD has done so far to fortify its mandate. As a last point, I consider briefly some implications of the kind of argument I've made for the way we think about institutions in international politics and specifically about the nature of explanations that can be constructed to take them seriously.

The regime literature of the late 1970's took as its primary challenge explaining what international institutions do. Krasner's celebrated edited volume asked, are regimes an autonomous variable, an intervening variable, or merely epiphenomenal?[229] In simpler language the question was: what kind of causal impact do regimes have in international politics, relative to states' interests. In the middle 1980's this was overtaken by a new agenda, explaining why the institutions established by American power were not deteriorating as broadly or as quickly as the power resources themselves.

These two research strands taken together yielded impressive results.[230] But by the middle 1980's it was also clear that the debate was getting confused because not everyone talking about international institutions was speaking the same language. Robert Keohane in an important 1988 article characterized two different dialogues, which he labelled rationalist and reflectivist.[231] Rationalists, close to the realists in their conception of the state and its interests, saw bounded rationality and costly and imperfect information as environmental constraints which states had to manage. For states like these, institutions could function to reduce in various ways transaction costs and thus facilitate agreements and contracts. Reflectivists began with a different conception of the state, rejecting the focus on autonomy and independently- defined interests, and the exogenous nature of environmental constraints. In their view, states and the international environment -- by implication

interests and institutions -- were mutually constitutive and could not be separated even for the sake of analysis. Keohane made the important point that while the reflectivists asked intriguing questions about institutions and had some worthy critiques they had not yet offered a research agenda of their own as coherent and as powerful as that belonging to the rationalists. Keohane's point stands as a challenge.

In my judgement the reflectivists have not yet met that challenge. But there was always a third view, somewhere between the two schools marked by Keohane, which came significantly more close. This is an approach that James Caporaso calls "institutionalist".[232] Here institutions are independent variables that, while not constitutive of the actors per se, do shape interests, which are no longer exogenous. States exist independently but their interests, in other words, are affected by ideas, values, or norms propagated through institutions. The key is that neither the ideas nor the institutions are reducible in any reasonable way to power, either in explaining why one institution gets selected over others or in exploring what institutions do once they are in place. Functional explanations won't work either, because even if states define a problem jointly there is almost never only one functional solution to it that involves institutions. When there are many alternatives the institutionalist approach does not generate a priori, generalized criteria for favoring one over another.

Clearly, the story I have told about EBRD falls within the realm of the institutionalist approach. It also demonstrates the limits of that approach. More favorably, it says something about what kinds of explanations <u>are</u> possible for institutionalists.

Why does one institution get selected over others at a particular moment in history? When power is concentrated in one state the question is easier to answer,

in principle, than when it is not. I've offered in this paper a historically contingent explanation for the EBRD, and I would not pretend to do more. I think it is impossible to do more. Chance plays an important role in initiating these events and the consequences of chance may not dissolve over time.

The forces that led to a major change in world politics around 1989 and opened up Europe for new institutions were running almost separately, in a different current of history as it were, from the stream of ideas about how to organize support for developing economies, that made the EBRD possible. The two streams intersected at the end of the 1980s, mostly by chance. The effort to establish a new institution drove forward convergence on ideas within the second stream, but this depended heavily on timing. If the change in world politics had come earlier or perhaps later the seeds of that convergence might not have been in place as they were in 1989. There might have been a consensus on very different ideas or no consensus at all. In either case the institutions that came out would have been different, perhaps very different, to EBRD. Given that kind of contingency, it is difficult to see how "strong" a priori criteria could predict the selection of one or another institution.[233]

This matters deeply only if the effects of chance are not damped out over time, and if the outcome does not regress inevitably to power. Is it inevitable? The institutionalist approach rests on the argument that it is not. It accepts, as I do here, the realist-inspired view that state actors will choose to exit an institution when their particular interests are debilitated to a greater degree than the cost of exit.[234] But in the institutionalist account those particular interests are no longer determined exogenously; they are affected fundamentally by what institutions do. Hence the notion of self-reinforcement. If institutions generate re-definitions of states' interests that are in turn strengthened by the institutions and the outcomes they produce, states will become less likely to exit the institution, no matter how

contingent or chancy the origins of that institution. A dynamic equilibrium of sorts could be established, on a trajectory that is different from the baseline trajectory of states, power, and interests defined exogenously.

This points to the possibility of multiple equilibria. In any given setting there might be more than one institutional structure that could self-reinforce and thus establish its own equilibrium with states and their interests. But only one of those potential equilibria will in fact be established, and which one it is may depend on chance, unrelated events.[235] The institutionalist approach leads thus to a path-dependent view of history, with a particular concentration on the "moment" of selection. In that kind of narrative, there may be several possible trajectories but selection of one over another occurs early on. Other trajectories might have been equally feasible or even more "optimal" but they will not be reached, since the selected path has its own positive returns. "Regression to the mean" or to some starkly-defined realist baseline is not inevitable at all.

This kind of argument does not generate a priori explanations, at least not in the sense that the neo-realist scholarship of the 1980's demanded. What it does produce is a contingent, path-dependent narrative that focuses on the selection of a particular path and on the conditions under which it can establish its own dynamic equilibrium. That may not look like a pure argument but it does have clear and testable implications. Some of those will be tested at EBRD over the coming years.

---

[1] John Mearsheimer, "Back to the Future: Instability in Europe After the Cold War", International Security 15 Summer 1990, provides a snapshot of what we might expect to see if the world were indeed operating as these arguments suggest.

[2] Although not necessarily in a linear relationship; I return to this point later.

[3] EBRD Articles of Agreement, Article 1.

[4] As hegemonic stability or cooperation after hegemony arguments might have it. I discuss both of these perspectives in detail later.

[5] I thank George Breslauer and Vinny Aggarwal for reminding me of this point repeatedly but in a constructive way.

[6] See Ernst B. Haas, When Knowledge is Power: Three Models of Change in International Organizations. Berkeley, CA: University of California Press, 1990.

[7] See, for example, Article IV of the International Bank for Reconstruction and Development Charter, which says "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". Similar language appears in the charters of the International Development Agency, the International Financial Corporation, the Multilateral Investment Guarantee Agency, and the regional development banks for Asia, Africa, and the Americas. Practice has not always followed this principle of course, but the intent is clear.

[8] "Recipient Countries" originally were Bulgaria, Czechoslovakia, Hungary, Poland, Romania, and Yugoslavia. I consider the former Soviet Union and the Baltics separately, and exclude the former GDR.

[9] I discuss these provisions in detail later in the paper.

[10] The principal challenge of the regime theory literature, for example, is to show that international institutions change the behavior of states or otherwise influence

international outcomes.

[11] For example, see Stephen Krasner, "Global Communications and National Power: Life on the Pareto Frontier", World Politics 43, April 1991.

[12] It could also in principle lie in an "intermediate group" or in Russell Hardin's "k-group", a small committee where cooperation through shared interests can possibly be sustained. But neither Olson, Hardin, nor the IR theorists making use of their work have been able to specify conditions under which such a committee could form. Generally, realist theory is formally agnostic and informally pessimistic on this score. Duncan Snidal provides a more optimistic formalization of the prospects for perpetuating institutions after hegemony in an area of pre-existing cooperation. He argues that a k-group would have to be "small" in order to operate effectively; but what small means depends in Snidal's argument upon a lot of [unspecified] things lumped together loosely as the "sociopolitical interactions among the members". "The Limits of Hegemonic Stability Theory", International Organization 39, Autumn 1985, p. 599.

[13] See for example Robert O. Keohane, After Hegemony: Cooperation and Discord in the World Political Economy. Princeton NJ: Princeton University Press, 1984; Keohane, "International Institutions: Two Approaches" International Studies Quarterly 32, Dec. 1988, pp. 379-396. In the article Keohane favors the rationalist view of institutions, which suggests that extant institutions are preserved because they modify transaction costs and facilitate strategies that states want to pursue, with pre-determined preferences.

[14] G. John Ikenberry and Charles A. Kupchan, International Organization 44 Summer 1990.

[15] When issues are less vital, epistemic communities of non-state or transnational actors have sometimes found success setting an agenda for inter-state cooperation and convincing state actors to follow their lead. Cite examples.

[16] Krasner, "Global Communications". In the "Battle of the Sexes" game, it is

entirely possible that the husband and the wife will not be able to agree on the mountains or the ocean for their vacation and end up in discord, although that is an outcome neither would prefer.

17 As I note later, American negotiators recognized clearly that the Europeans led by the French were going to go ahead with or without US participation.

18 Scott C. James and David Lake describe these as the "three faces of hegemony" in "The Second Face of Hegemony: Britain' Repeal of the Corn Laws and the American Walker Tariff of 1846", International Organization 43, Winter 1989, pp. 1-29.

19 At Houston in July 1990, the G-7 decided essentially that each country would go its own way on aid to Moscow, at least pending the outcome of a massive study of the Soviet economy that was carried out by the World Bank, the IMF, the OECD, and the EBRD in the autumn. When the 7 met again in London in July 1991, they agreed loosely on a program that is remarkably close to what the results of that study imply.

20 "Bonn Giving Poles Aid of 1 Billion", New York Times, 26 October 1989, p. 1; "Kohl Recalls Auschwitz and Agrees to Aid Pole", New York Times, 15 November 1989, p. 14.

21 "Indicative Financial and Aid Commitments and Near Commitments in Favour of Poland and Hungary", PHARE internal document, 5 March 1990.

22 "Poland's Foreign Lender Accept Unusual Extension of Payments", and "Polish Debt Rescheduling Deal", New York Times 17 February 1990, p. 1 and p. 2. In January 1990, prior to the Paris Club Agreement, Polish debt was trading on secondary markets at about 19 cents to the dollar -- and being purchased primarily by German banks, with some Austrian participation as well. "Eastern Bloc Shift Worries Western Banks", New York Times 4 January 1990, p. C 1.

23 "Investing in the Revolution", Financial Times, 15 January 1990, p. 16. Polish government officials did not hesitate to express their fears to Americans, notably to

an official delegation of US business leaders led by Secretaries of Commerce and Agriculture Mossbacher and Yeutter, who were told as early as December 1989 that Poland "looks to the US to balance Germany's economic might." "Poland's Hope for Strong US Investment May be Misplaced, At Least in Short Run", Wall Street Journal 7 December 1989, p A13.

24 Discomfort was not confined to Poland. In July 1990, a high Czech official visiting Washington called publicly for "pluralism" in foreign investment to counter "terrible pressure" from West German money. He argued that much of his country's hesitation in privatizing enterprises and reforming investment laws to allow for majority holding by foreigners resulted from fear that productive sectors of the economy would be bought up quickly and almost exclusively by Germans. "Premier of Czechs Plans US Trip to Seek Capital", New York Times 19 July 1990, p. A7.

25 This report is excerpted in "Central Europe Urged to Lay Welcome Mat for Foreign Investors", Financial Times, 31 July 1990, p. 2. Austria and Switzerland were also major investors in Hungary, with the US at this time far behind. Sweden, Austria, the United States, and France were all substantially present in Poland -- but their combined share of foreign investment was still less than that of Germany.

26 In Poland, for example, foreign direct investment of German firms by summer 1991 made up 26% of capital and 39.2% of enterprises with substantial foreign ownership. "Central and Eastern Europe in Transition", Schroder Economics, August 1991. See also The Economist 29 June 1991.

27 For comparison, French FDI in Poland as of summer 1991 amounted to only 1.6% of capital and only 3.8% of enterprises. "Central and Eastern Europe in Transition", Schroder Economics Report.

28 It is not necessary to ascribe to French elites "paranoid insecurity" of German power in order to understand these concerns: a realpolitik rendering of interests is quite sufficient. Interview with EC official, June 1990. For a brief analysis of

France's response in the parallel debate over evolving security institutions in Europe, see my "Security After 1989" and "Does NATO Have a Future?"

29 Interview with Official of the French Foreign Ministry, May 1990.

30 "Polish Debt Rescheduling Deal", Financial Times, 17 February 1990, p. 2; "Poland's Foreign Lenders Accept Unusual Extension of Payments", New York Times, 17 February 1990, p. 1.

31 Albeit short of a total cancellation of the country's official debt. "France Agrees on Aid Package for Poland", Financial Times, 30 May 1990, p. 3.

32 Interviews with EC Official, June 1990; US Foreign Service Officer in Europe, June 1990; EC Representative in US, May 1990.

33 For an argument about some of the causes of this shift and its consequences for EC integration, see Andrew Moravscik, "Negotiating the Single European Act", International Organization 45 Winter 1991, pp. 19-56.

34 I discuss the delay and some of the accompanying debates in "Security After 1989".

35 See Interview with Jacques Attali, Financial Times, 15 April 1991.

36 In 1988 Japanese trade with this part of the world amounted to just .4% of total Japanese trade. 1989 Japanese exports to E. Europe were about $469 million, just .23% of total exports. Imports, mostly agricultural and marine products, amounted to only .35% of total imports.

37 See report of Survey by Japan External Trade Organization, reported in Financial Times, 5 June 1990, p. 3. There were three general reasons: economic (quality of production resources, reliability of local suppliers and parts networks, etc.), political (friendliness and reliability of national laws regulating foreign investment), and cultural (familiarity with language and patterns of life of the workforce).

38 "Japan Moves Toward Modest Aid for Poland", New York Times, 29 October 1989, p. 19.

39 An unnamed high ranking Foreign Ministry Official was quoted as saying that Eastern Europe would be an important place to "show our position as a major player among the Western nations" -- a comment that apparently irritated colleagues at the Finance Ministry. "Japan Moves Toward Modest Aid for Poland", New York Times, 29 October 1989, p. 19.

40 The Finance Ministry was resistant even to this sum, and was able to attach conditions to it surprising for such a small amount of money. It was to be provided as low-interest loans, not a grant; and would not be made available until the Polish government signed its letter of intent with the IMF. As a further condition, no additional money could be offered until Poland agreed to reschedule payments on more than $1 billion in import credits, now in arrears, that were provided to the former communist government during the 1970s. Interview with World Bank Official, December 1990. See also "Japan Will Help Poland and Hungary", New York Times, 26 September 1989, p. 7. Kaifu's trip was carefully timed to precede Japanese parliamentary elections in February, and it was generally acknowledged in private that an important objective of the trip was to portray the Prime Minister as a "world statesmen" of stature concomittant with Japanese economic power

41 In addition, Kaifu promised $150 million for the Polish Zloty stabilization fund, $25 million food aid, and $25 million to support technical assistance. "Japan's Prime Minister is Ready to Seek Closer Ties with European Community", Wall Street Journal, 10 January 1990, p. 10.

42 Japan Economic Journal, 13 January 1990, p. 1.

43 "Tokyo Broadens Plan to Aid a New Poland and Hungary", New York Times, 7 January 1990, p. 8.

44 "Japanese Prime Minister Promises More Economic Aid for Hungary", New York Times 17 January 1990, p. 7. EC nations criticized in particular the conditions attached to Japanese aid.

45 The Economist 29 June 1991.

46 "Suzuki Reaches Accord to Build Cars in Hungary", Wall Street Journal, 10 January 1990. This $260 million assembly plant was, in the context of what Japanese automakers were doing elsewhere in the world, a small investment (to produce annually 50,000 cars, less than a fourth of what Japanese auto companies typically seek in overseas installations).

47 Japan Economic Journal 24 February, 1990.

48 This report predicted that after two difficult years Eastern Germany would begin to grow so quickly as to gain economic parity with Western Germany not long after the turn of the century. "Japanese Bank Sees 10% Growth for E. Germany", Financial Times 28 June 1990. Nevertheless, few Japanese companies expressed interest or planned substantial moves into the region: Nissan has opened a number of dealerships, Sony a marketing office, and Kao (a toiletry concern) is developing a joint venture to produce shampoos.

49 Japan Economic Journal, 20 January 1990.

50 Early in September, the President announced that he would double from 50 to $100 million US food aid to Poland, adding to a pledge of $119 million for technical and environmental assistance which Bush had made in July. Although the White House was reluctant to do more than this, arguing that more money at present would be wasted because "they don't know how to use it effectively", the administration at the same time "concluded that Congress is determined to vote more aid for Poland" than what the President wanted." "US Considers New Steps to Help Polish Economy", Wall Street Journal, 29 September 1989; "White House Adds $200 Million to Polish Aid Plan", New York Times, 5 October 1989, p. 11.

51 This money was committed to the Polish zloty stabilization fund. "Bush Proposes Aid of $200m for Poland Fund", Wall Street Journal, 5 October 1989, p. 3.

52 "House Approves an Aid Package for Poland", New York Times, 17 November 1989, p. 15; "Congress Approves Aid Plan of $852 million for Poland", New York

Times 19 November 1989, p. 28.

53 The total budget for foreign aid in 1990 was just $14.6 billion, down from $15.1 billion in 1981, not adjusted for inflation -- and Panama was an important competitor for discretionary funds. Still, Central America lost out overall to E. Europe in this budget. "Poland is Big Winner as Administration Lists Shifts in US Foreign Aid", New York Times, 1 February 1990, p. 4.

54 The Economist, 29 June 1991.

55 "Bush's Business Friends Back His Vision of Europe", Financial Times, 28 December 1989.

56 See for example "Investing in the Revolution", Financial Times, 15 January 1990, p. 16. Even General Motors, present in Western Europe for many years with a double-digit market share in most EC countries, emphasized the great impediments that stood in the way of CEE's economic "potential" and concluded pessimistically that "caution is the byword for Western firms contemplating doing business in Eastern Europe". Interview with John F. Smith, Vice-Chairman of GM, quoted in Europe, September 1990, p. 18.

57 Testimony of Mark Palmer, former US ambassador to Hungary and then director of the private Central European Development Corporation, in United States Policy Toward Eastern Europe, Hearing Before the Subcommittee on Europe and the Middle East, Committee on Foreign Affairs, House, 101 Congress 2nd Session, June 5 1990, p. 6. The American-Hungarian Enterprise Fund would become much more active in 1991, however.

58 Interview with US Foreign Service Officer In Europe, June 1990.

59 Interview with US Foreign Service Officer in Europe, June 1990; Interview with US NSC Official, December 1990.

60 Baker called for "whether in treaty or some other form, a significantly strengthened set of institutional and consultative links" between Washington and the EC. Speech in Berlin, Dec. 12 1989, reprinted in New York Times 13 December

1989, p. 18.

61 Speech delivered at Aspen Institute in Berlin, June 18 1991, reprinted in US Department of State Dispatch Vol 2, No. 25, 1991. This speech recapitulates traditional American beliefs about the stability and desirability of a world where US and Europe act in tandem as close foreign policy associates. I discuss sources and earlier consequences of those beliefs in "Multilateralism in NATO".

62 The G-24 held its first coordination meeting on 1 August 1989. It consists of the G-7, the European Commission, the other EC and EFTA countries, Australia, Canada, Japan, New Zealand, and Turkey.

63 At first the program was limited to Poland and Hungary only; it would be extended to other countries committed to meeting these conditions in the fall of 1989. "The Development of the Community's Relations with the Countries of Central and Eastern Europe", Communication from the Commission to the Council and the Parliament, Brussels, 1 Feb. 1990.

64 A US Foreign Service Officer in Europe and an EC official connected with the PHARE program both told me of broad agreement on the idea that the Eastern European countries needed clear signals on political reform and that they needed them quickly. Interviews, June 1990. A US State Department Official with personal knowledge of the discussions said of political conditionality that "nobody had a serious problem with this", although the US at least did raise some concerns over details of how the conditions would be evaluated operationally. The December 1989 communique (which I discuss next) met those concerns. Interview, Washington DC, December 1990.

65 "Conclusions of the Group of 24 February Meeting", EC News No. 5/90, 20 February 1990. It was agreed that "as coordinated assistance is intended to **facilitate** political reform and economic liberalisation, it would not be reasonable to require the demonstration of success in implementing reform as an **initial** condition for participation in assistance programs. It is, however, necessary to require firm

commitments to democratic elections and economic liberalisation, preferably within a specified time-table." "The Development of the Community's Relations with the Countries of Eastern Europe" [emphasis added].

66 Interview with US State Department Official in Europe, June 1990.

67 US Congressman Tom Lantos reportedly captured this sentiment in a speech to European Parliamentarians early in 1990, in which he argued that the US had liberated the Europeans first from Nazi domination and then from economic poverty, and in doing so had encouraged processes that led to the integration of Europe. It was now up to Europe to take a leadership role for the third liberation, of CEE, in its own backyard. Interview, US Foreign Service Officer in Europe, June 1990.

68 Commercial banks lent to the region, in billions of dollars, 2.78, 2.78, 1.26, 3.34, and 1.62, from 1985 - 1989. Institute of International Finance.

69 Less incentive to protect existing loans by lending new money to CEE is one reason why US banks in particular did not feel compelled to move aggressively into this market. Another reason is that many of the large US banks were trying to consolidate their operations and set aside reserves for losses in Latin America: a high Citibank official noted in 1985 that with US banks feeling "very exposed in terms of their portfolios overseas" they would for some time to come be reluctant to make new and risky investments abroad particularly "given the atmosphere that has existed since the Mexican restructuring". (Testimony of Charles Meissner, Filling the Capital Void in the Developing World, Subcommittee on International Development Institutions and Finance, Committee on Banking, Finance, and Urban Affairs, House, 99th Congress 1st session, 9 July 1985). The political upheavals of 1989 did not change that sentiment much. When asked about commercial bank interest in Poland in December 1989, the CEO of First Chicago Corporation said that neither his bank nor others were in a risk-acceptant mood: "we are all working to repair capital. We're talking about how to husband every one of our dollars. I

don't know of any reason to think of Poland as being an unusually attractive investment in the short run". Quoted in "Poland's Hope for Strong US Investment May be Misplaced, at Least in the Short Run", Wall Street Journal, 7 December 1989, p. 13.

70 Poland had been paying interest on its loans to commercial banks (but not to governments) until the fourth quarter of 1989, when in October the new Solidarity Government cut those payments to 15%, affecting $180 million in payments on $9 billion of outstanding commercial debt. A Shearson analyst summed up the mood among the banks: "the market is anticipating more debt service interruptions from Poland, followed by Western Government pressure on commercial banks to offer substantial debt relief". "Eastern Bloc Shift Worries Western Banks", New York Times, 4 January 1990, p. C1. The market guessed correctly. In February, the Paris Club signed with Poland an agreement to extend payment on $9.4 billion debt at concessionary terms and over 14 years; this was the largest amount of debt yet re-scheduled by the club, and for the longest time period. It had the effect of reducing Poland's annual repayment obligations from about $3 billion to about $1.1 billion; even this was labelled by governments an "interim measure". "Polish Debt Rescheduling Deal", Financial Times 17 February 1990, p. 2. Warsaw followed several months later by requesting debt forgiveness totalling 80% from both banks and governments. "Poland Proposes Reduction on Debt", Financial Times 15 June 1990, p. 2.

71 "Banks Wary Over Loans to Eastern Europe", Financial Times, 1 March 1990, p. 2.

72 While new lending for July - December was reported to be flat globally, new loans to CEE dropped at least 4% from already cautious levels of a year earlier. Bank of International Settlements Survey, reported in New York Times 17 July 1991.

73 I have already detailed some of the impediments to joint ventures and DFI by

multinational corporations. In summer 1991, the World Bank Transitions report quoted the following statistics: "out of 3000 joint ventures registered in Poland, only about one third are actually operable and only a tiny portion of the one third is worth more than the $50,000 required investment. In Czechoslovakia, the number is more like 600 and the money involved even less. With about 5000 registered joint ventures, things are better in Hungary, although major deals have been slow in coming there too" (June 1991, Vol. 2 No. 6 p. 10). The costs to CEE countries of raising capital on the international bond markets rose significantly at the same time, mainly because of deteriorating creditworthiness. Investment by financial intermediaries other than commercial banks (insurance companies, pension funds and the like) was hampered by sluggish administrative reforms and the lack of suitable opportunities for portfolio investment; and foreign-currency denominated assets of residents and expatriates were not heavily attracted to CEE, as some Western analysts had hoped for.

[74] Indeed, it was quite old. A century earlier (in 1889) the US had killed a proposal from the First International Conference of American States to set up a regional bank for the Americas, on the grounds that it would compete unnaturally with private banks. After World War II the US argued that the World Bank made a regional bank for the Americas superfluous and maintained that position until political incentives changed -- after Vice President Richard Nixon's tumultuous visit to Latin America in 1958. The US resisted proposals to set up an Asian Development Bank in the early 1960s again on the basis of economic arguments, and again changed its position for political reasons -- this time connected to events in Vietnam. See Sidney Dell, The InterAmerican Development Bank: A Study in Development Financing, (New York: Praeger, 1972); W.W. Rostow, The United States and the Regional Organization of Asia and the Pacific, 1965 - 1985, (Austin: University of Texas Press, 1986); Dick Wilson, A Bank for Half the World: The Story of the Asian Development Bank, 1966 - 1986 (Manila: Asian Development

Bank, 1987); Philip L. Geyelin, Lyndon B. Johnson and the World (New York: Praeger, 1986).

75 See for example the testimony of C. Douglas Dillon, prominent former Treasury Secretary, in 1985, in US Role in the International Economy, Subcommittee on International Development Institutions and Finance, Committee on Banking, Finance, and Urban Affairs, House, 99th Congress 1st session, 9 May 1985, p. 8 and p. 30.

76 For example, see Hobart Rowan, "The Washington Agenda", Institutional Investor 15 Sept. 1981 pp. 337-8; and the summary article by A.W. Clausen, "The US and Multilateralism", in Alvin Paul Drischler and M.P. Benjenk, eds., US Policy Toward the Bretton Woods Institutions, Foreign Policy Institute SAIS, 1988, p. 6. Undersecretary of the Treasury for Monetary Affairs Beryl Sprinkel was known during the first Reagan administration as a particularly strident voice on this issue.

77 Testimony of James W. Conrow, Deputy Assistant Secretary of Treasury for International Affairs, in To Provide for Increased Participation By the US in the IBRD, the IFC, and the African Development Fund, Subcommittee on International Development Institutions and Finance, Committee on Banking, Finance, and Urban Affairs, House, 99th Congress 1st session, 16 April 1985, p. 9 and p. 23.

78 See IBRD Charter, Article III(4)(i). A major motivation for this restriction was to safeguard the bank's excellent credit rating, which has allowed the World Bank to borrow money at competitive rates on international bond markets and pass that advantage on to its poor client borrowers.

79 Prior to 1983, almost all Asian Development Bank (ADB) lending to the private sector was conducted through intermediaries - local development finance institutions - the vast majority of which were state owned. The ADB began direct equity investments in private enterprises in 1983 and made its first direct loan without government guarantees in 1985. By 1988, the Bank's private sector operations

totaled about $160 million in loans, equity, and underwritings. (1988 ADB Annual Report). Also see Wilson, A Bank for Half the World.

80 See testimony by Henry Owen, representing the Bretton Woods Committee, in US Role in the International Economy: The Value of US Participation in Multilateral Development Banks, Subcommittee on International Development Institutions and Finance, Committee on Banking, Finance, and Urban Affairs, House, 99th Congress 1st session, 4 April 1985, particularly p. 44. The World Bank Directed Credit Program and the European Investment Bank Global Loan Program are important examples; in the latter case, less than half of the enterprises funded outside the EC have been profitable (EIB Annual Report 1988, p. 64). It is not only MDBs that lend via national development banks; this was also a common practice for private international commercial bank lending, particularly to Latin America in the 1970s. See Jeffrey Frieden, "Third World Indebted Industrialization", International Organization 35 Summer 1981 pp. 407-431.

81 Comments of US World Bank Governor William E. Simon, 1975 Annual Meetings of the Board of Governors Summary Proceedings (World Bank: Washington DC, 1975).

82 In 1977 for example, Senator Tom Harkin led a vocal campaign in favor of section 701 of the US International Financial Institutions Act, which required the US director to vote against proposed World Bank projects in countries that violate grossly internationally recognized human rights "unless such assistance is directed specifically to programs which serve the basic human needs of the citizens" Agres, p. 55.

83 Henry Owen in 1985 put it thus: "until recently development theory failed to take sufficient account of the importance to the development process of a healthy private sector and free operations of market forces. Now it is increasingly understood that success...is more likely in economies with healthy private sectors." David Rockefeller seconded the point: "the startling success of developing nations

favoring market oriented economies...demonstrate to the world at large the intrinsic value of adopting econonomies with a strong private sector approach." US Role in the International Economy: The Value of US Participation in Multilateral Development Banks, Subcommittee on International Development Institutions and Finance, Committee on Banking, Finance, and Urban Affairs, House, 99th Congress 1st session, 4 April 1985, p. 23. p. 52, 5.

84 For a somewhat different view that emphasizes effect as opposed to intention see Thomas J. Bierstecker, "Reducing the Role of the State in the Economy: A Conceptual Exploration of IMF and WB Prescriptions", International Studies Quarterly 34 December 1990, pp. 477-492.

85 Among IFIs, the IMF played the most visible and important role in macroeconomic adjustment toward these ends, emphasizing four major elements: exchange rate corrections, anti-inflationary demand management measures (monetary and fiscal tightening, combined with wage restraints), the creation and restoration of markets (by eliminating price controls and subsidies, and liberalizing trade and DFI), and privatization. Bierstecker, "Reducing the Role of the State in the Economy".

86 The US was originally skeptical of the bank's ability to administer effectively such programs. Washington's position in 1982 was that World Bank structural adjustment loans must have definite, monitorable performance criteria and must in any case be limited to 10% of the bank's lending activities. In 1985, the US dropped its insistence on the 10% limit and by 1987 policy lending made up nearly a quarter of the World Bank's activities. In 1988, Secretary Baker described World Bank structural adjustment loans as "an integral part of our approach to the debt strategy". Testimony in Hearing on the General Capital Increase for the World Bank, US Congress, Committee on Banking, Finance, and Urban Affairs, June 15 1988, p. 21.

87 The new "B-loan" plan, launced as a pilot program in 1983, included much

more firm guarantees than did the traditional "A-loan" method of cofinance. For details of the two plans, see Filling the Capital Void in the Developing World, Subcommittee on International Development Institutions and Finance of the Committee on Banking, Finance, and Urban Affairs, House, 99th Congress, 1st Session, July 9 1985.

88 The Bank also established in 1988 a high level panel, the "Private Sector Development Review Group", to assess the private sector activities and impact of IBRD, IFC, and MIGA. It also began to experiment more widely with non-traditional financing programs aimed at private enterprise; such as supporting for the first time a Build-Own-Operate (B-O-O) concession, on an electric utility in Pakistan in 1991.

89 Although the IFC itself has historically alloted about 40% of its resources to Latin America, most of those funds have gone in practice to a few large projects in large countries. The Inter-American Investment Corporation is supposed to emphasize more and smaller projects in a broader range of countries.

90 Testimony of James W. Conrow, Deputy Assistant Secretary of the Treasury for International Affairs, To Provide for Increased Participation By the US in the IBRD, the IFC, and the African Development Fund, Subcommittee on International Development Institutions and Finance, Committee on Banking, Finance, and Urban Affairs, House, 99th Congress 1st session, 16 April 1985, p. 23.

91 "US Urges World Bank to Boost Private Lending", Financial Times 19 April 1991, p. 1; "US Seeks to Raise World Bank's Private Profile", Financial Times 1 May 1991, p. 6. This was seen generally as a bargaining gambit by Treasury. The wording of the proposal was deliberately elastic: the meaning of the phrase "lending directed toward the private sector" could be construed to include many different kinds of support for public infrastructure projects that would support further private investment. The notion that the World Bank should lend directly to the private sector, which would require fundamental changes in the organization's charter and

practice as well as put at risk its preferred credit rating, was portrayed by Treasury officials as an "ultimate" not immediate goal.

92 Treasury officials described the requested changes as "modest"; David Mulford noted specifically that the US did not seek an immediate change in the World Bank charter. But Washington's three-pronged request -- that the bank create a committee chaired by the bank President to conduct a quarterly review of progress in encouraging the private sector; that it hire 20 executives to monitor specifically that progress, and that it review the charter "to determine whether it allows adequate flexibility in lending to Third World businesses" -- was not modest in its potential significance. "World Bank Accord Seen on Private Lending", New York Times 28 June 1991, p. C1; Financial Times 26 June 1991, p. 6.

93 Board members, reportedly irritated by the "aggressiveness of the US", criticized the "bank's willingness to change its policies under US pressure" and raised concerns about potential consequences of the US plan for the bank's commitment to poverty alleviation. A compromise plan was first rejected at a "tense and somber meeting" of the board on June 20 but was revived and accepted with cosmetic changes the following week. "World Bank Policy Shift Backed by US is Rejected", New York Times, 21 June 1991; "World Bank Accord Seen on Private Lending", New York Times, 28 June 1991.

94 World Development Report 1991, (New York: Oxford University Press, 1991). The report reads overall like a primer on privatization, trade liberalization, and realistic currency exchange rates. It accepts an important role for the public sector in specific infrastructure needs but stresses the view that government intervention should be seen as "a scarce resource to be employed sparingly".

95 Put differently, the problem was more than just one of market failure, and the impediments to adequate capital flows toward CEE went beyond missing or expensive information, excessive transaction costs, and the like.

96 Although there was, as I shall show, important disagreement over precisely

what "European" meant.

97 Interviews with two senior EC officials of DG-I (external relations), June 1990. Limits on US initiative were thought to arise from constraints on how quickly the bureaucracy could act and more fundamentally from finances.

98 "Bush Calls for Speeding Initiatives to Help Mend Poland's Economy", Wall Street Journal,28 September 1989, p. A 22.

99 See the earlier discussion of Kohl's initiative in October.

100 See report in "Bonn Giving Poles Aid of $1 Billion", New York Times, 26 October 1989, p. 1.

101 Interview with Senior EC official, DG-II, June 1990; Interview with PHARE Official in Brussels, June 1990; Interview with EBRD Official, June 1991.

102 Interview with EBRD official, June 1991.

103 The French proposal pictured the bank as an autonomous institution, separate from and independent of the EC per se, with status analagous to the European Investment Bank. This was justified as a necessary step for efficiency when it came both to setting up the bank and to operating it. Interview with EBRD officials, June 1991. Of course, keeping the bank on the margins of the Community also granted the French de facto leadership rights, since Mitterand and Attali were principally responsible for the idea.

104 "Western Europe Pledges to Aid East", New York Times,19 November 1989, Section I p. 28.

105 The Troika consists of the past, present, and future President of the European Council (six- month terms). In November of 1989 that meant Spain's Prime Minister Felipe Gonzalez, Mitterand, and Ireland's Prime Minister Charles Haughey.

106 European Commission, D-G Information, Communication, Culture. ICC Background Brief Update 7 Dec. 1990.

107 Interview with US Federal Reserve Official, December 1990.

[108] While emphasizing the point that the EBRD was "not a proposal of the Commission" but rather "an initiative by one of the member states, France", a high EC official was at pains to point out that the Strasbourg agreement specified "that there should be a majority of the shareholding for the member states and the community itself and that other countries, and in particular the member countries of the OECD, would be invited to participate." (emphasis added) In what he described as "one of the vital points" of the accord, this official noted that the role of the Community was interpreted "not only as a question of shareholding but also in terms of, for example, membership of the Executive Board." Presentation by Mr. Williamson, Secretary General of the Commission, at the Meeting of the Committee on Budgets, 2-19-90, printed by European Parliament on 3-20-90, PE 140.046.

[109] Interview with EC Official, DG-II, June 1990; Interview with PHARE official, June 1990. Broadening the membership also suited the Commission's interest in establishing the Community's decision making role in preference to the G-7, which includes only the largest of the 12. This is an important political issue for the cohesion of the Community, where the smaller states (Holland, for example) sometimes express dismay at being carried along, via the Community, by G-7 decisions in which they had no substantial input. The British, the Germans, and the Dutch were also supporters of a central American role in the bank.

[110] Interview with EBRD official, June 1991. This official noted that Mitterand could not really speak with the authority of the Community, since the Presidency of the Community was about to pass on January 1 on its regular six month cycle from France to Ireland. Commission officials told me of considerable annoyance in Brussels at Mitterand's move. They expected that leadership on the bank project now belonged to the Community and would pass to the Ireland when it assumed the Presidency. Interviews, June 1990.

[111] Interview with EBRD official, June 1991.

[112] Although worries about "fortress Europe" connected with 1992 began to

diminish somewhat in the US and elsewhere as trade regulations and agreements were settled during 1988, those concerns were re-ignited in 1989 as part of the uncertainty surrounding how the Community and its member states would respond to dramatic political changes in CEE.

113 There were some informal discussions held with American officials before this meeting. Interview with US NSC official, December 1990. See also "Bush and Mitterand Meet Today on Europe's Role, New York Times 16 December 1989, p. 5.

114 Treasury officials were concerned, with good reason, that the administration might find it hard to gain funding for American subscriptions to a new IFI from a wary Congress, where resistance to multilateral financial institutions was already the source of annual battles over appropriations. Of course, the US seemed poised to gain if aid to CEE were handled through existing or even new facilities at the World Bank and IMF, where the US would have a greater say than at EBRD.

115 Interviews with US NSC Official, December 1990; US State Department Official in Brussels, June 1990; EBRD Officials, June 1991.

116 Ibid. Several people told me that Brent Scowcroft played a central role in support of American participation as a symbol of continued US commitment to Europe, but I have not been able to confirm this directly.

117 "Brussels Steps Up the EC Drive to Aid East Europe", Financial Times, 12 January 1990, p. 3.

118 Ibid

119 "New Bank to Help East Bloc Revive Its Economy", New York Times, 14 January 1990, p. 10.

120 Interview, PHARE Official, Brussels, June 1990

121 It was less clear, at this point, how those terms would be defined or political conditionality implemented. Interview with US Foreign Service Officer in Brussels, June 1990.

[122] "Eastern Europe", in Europe General News, Agence Internationale D'Information Pour La Presse, Brussels, No. 5174, 1-18-90, p. 9.

[123] Interview with US NSC Official, December 1990.

[124] At his press conference Attali acknowledged this as a "delicate political question of great symbolic value". Europe General News 18 January 1990 p. 10.

[125] "Talks on a Bank to Finance East Bloc End in A Dispute", New York Times, 17 January 19 90 p. A6.

[126] Europe General News 18 January 1990, p.10; "Talks on a Bank to Finance East Bloc End in A Dispute", New York Times 17 January 1990, p. A6. For the most part, conferees from CEE supported the French position, arguing the need for infrastructure projects by the public sector in support of private investment.

[127] Interview with US Treasury Department Official, Nov 1990. This official told me that the EC 12 generally had agreed a set position on most issues by the February conference, and that the US found it hard to make inroads. The issue of policy lending was a notable exception.

[128] Interview with French Foreign Affairs Officer, May 1990; European Commission Official, May 1990.

[129] Interview with US NSC Official, December 1990. This official told me that some American participants in this meeting felt "like the French Plan looked very much like the failed multilateral development banks of the past, as if the French had learned nothing from the experience with Latin America".

[130] European Parliament Committee on Budgets, Presentation on the European Bank for Reconstruction and Development given by Mr. Williamson, Secretary-General of the Commission of the European Communities, released 20 March 1990, PE 140.046; Interview with US State Department Official in Washington DC, December 1990.

[131] Interview with European Commission Official in Brussels, June 1990. This official told me that relatively senior Treasury Department officials directly

involved in the negotiating sessions argued against inclusion of either EC or EIB as charter members on the grounds that the 12 EC states had their own shares, but were over-ruled on this point by the State Department.

132 Interview with Senior NSC Official, December 1990; US State Department Official in Washington, December 1990.

133 Interview with US NSC Senior Official, December 1990.

134 "New Bank for East-Bloc Aid Extends Scope to Public Works", New York Times 12 January 1990, p. A 9. The French compromised by accepting statutory limits which bound the bank's flexibility, while the US and the British sacrificed the principle that a new MDB should lend only to the private sector.

135 There was some internal wrangling in Washington over the American share. In February, the US had expressed interest in being the single largest shareholder with around 11%. David Mulford reportedly cut this to 8.5% at the March meeting, "to the dismay of senior White House Staffers" and in particular Brent Scowcroft. Treasury Department officials later said that they had reached an understanding that the US share would be *at least* 8.5%. "Treasury is Told To Seek Major US Role in Development Bank for Eastern Europe", Wall Street Journal 12 March 1990 p. A 12.

136 The US pressed for its own, non-rotating seat on the board, which assured that other large subscribers would do the same. The consequence would necessarily be a large board; at this point, the proposed number was between 16 and 22. (In the end the EBRD would have 23 full time resident directors. For comparison, the much larger World Bank has 22 executive directors; the AfDB and the ADB each have 12).

137 Testimony of David Mulford, European Bank for Reconstruction and Development, Hearings before the Subcommittee on International Economic Policy, Trade, Oceans, and Environment, Committee on Foreign Relations, Senate, 101 Congress, 2nd Session, 22 March 1990, p. 13.

[138] Mulford testimony, Ibid. Mulford admitted that earlier US arguments about the bank calling for a more severe application of these ideas had not been realistic, and now (among other things) "accepted the idea...that there must be some infrastructure development supportive of the private sector in many of these countries before credible private sector development can take place." (p. 11). Mulford also made the point that an ECU 10 billion EBRD limited to private sector lending would struggle to find sufficient bankable projects in CEE, and would end up either making bad loans to dispose of its resources or investing heavily in US Treasury Bills. Another striking feature of these hearings is that the positive link between political conditionality and economic success is never questioned seriously by either supporters or opponents of the EBRD.

[139] Mulford Testimony, European Bank for Reconstruction and Development, 22 March 1990, p. 20.

[140] Testimony of Ed Hewett, Senior Fellow at Brookings Institution in Washington DC; European Bank for Reconstruction and Development, 22 March 1990, p. 27. Hewett stressed that EBRD support for infrastructure would in fact achieve the most in moving impediments to US business.

[141] Development Finance Institutions historically have been the conduit from multilateral institutions to SMEs in developing countries. These programs have generally been unsuccessful, in part because the DFIs do not often have the human resources in place to identify, evaluate, and process many small borrowing requests. Much evaluation is based on personal not economic criteria and that opens the door for various kinds of inconsistency and corruption, even when DFIs are not owned or controlled by the state. The World Bank "Directed Credit Program" and the EIB "Global Loan Program" are examples

[142] I thank Catherine L. Mann of the US Federal Reserve Board for helpful discussions on this subject. Paul Craig Roberts of the Center for Strategic and International Studies argued that the EBRD would like other MDBs be strongly

inclined to lend to the state sector, because that is where the most visible opportunities would lie and because of the "corporate culture" that naturally develops in such institutions. In his view, it was "in our interest to make sure that we do not participate in any rear-guard socialist action that would result in the use of resources of a development bank to contain Eastern Europe in a bureaucratized economic life based on the allocation of entitlements." The European Bank for Reconstruction and Development, 22 March 1990, p. 24.

143 European Bank for Reconstruction and Development, 22 March 1990, p. 17.

144 Ibid, p. 5.

145 Mulford recognized that the bank's decision to use the ECU was important symbolically for this new European institution, but the Treasury refused to accept a shareholding commitment for the US in ECUs which would in practice be open-ended since it would be sensitive to exchange rates. European Bank for Reconstruction and Development, p. 5. This issue was also in part a matter of avoiding precedents, where (for example) the IMF might later justify calling for subscriptions in SDR.

146 Testimony of David Mulford, European Bank for Reconstruction and Development, 22 March 1990, p. 17. One week earlier, Treasury Secretary Nicholas Brady had told a House Subcommittee that "our position is that the US does not want to be a part of the bank if a major part of the funds are diverted to Soviet lending". In an acknowledged compromise from the earlier US position that the Soviets not be members at all, Brady asked that the bank limit Soviet borrowing to Moscow's hard currency, paid-in subscription for 5 years, with a change after that time requiring approval by countries holding 85% of the bank's shares. See report in "US Threatens Not to Join Bank for East Europe if Soviets Benefit", New York Times 15 March 1990, p. A 1; Testimony of David Mulford, 22 March 1990, p. 16.

147 Testimony of David Mulford, European Bank for Reconstruction and

Development, p. 17.

148 Senator Paul Sarbanes in particular worried that if the US did not participate in EBRD it would be seen as a failure to participate in the new Europe per se. Mulford denied this point, arguing that there were "other options for us to expand our influence and leverage" and that the US would still be involved through bilateral ties and other international institutions. European Bank for Reconstruction and Development, 22 March 1990, p. 17.

149 European Bank for Reconstruction and Development, 22 March 1990, p. 13.

150 "US Threatens Not to Join Bank for East Europe if Soviets Benefit", New York Times, 15 March 1990 p. A 1.

151 "The BERD Struggles to Leave the Egg", The Economist 7 April 1990 p. 60.

152 Not at all by coincidence, this would give the US and Japan (acting together) veto over any change in Soviet status.

153 Interview with US Federal Reserve Official, December 1990.

154 For further discussion see Fabrice Demarigny and Francois Vuillemin, "La Banque Europeene Pour La Reconstruction et le Developpement: Une Reponse Adaptee Aux Nouveaux Besoins de l'Est?", Esprit (Paris) Nov. 1990.

155 With the ECU worth about $1.25, that makes the original capitalization of EBRD around $12 billion, slightly larger in nominal terms than the original capital of the World Bank and about one-fourteenth of the World Bank's authorized capital ($171 billion) at the time the EBRD charter was signed. For comparison, at the World Bank an average of 7.5% of capital is paid in; at the IFC 100% of capital is paid in. These differences reflect principally the risks associated with lending to the private sector and without government guarantees.

156 It was also agreed that payment could be settled either in ECU, in US dollars, or in Japanese Yen on the basis of a exchange rate to be fixed by agreement. This meant in effect that the US, Japan, and European countries whose currencies fixed ECU value remains unchanged would have close-ended obligations to the bank; all

other subscribers would have open-ended obligations sensitive to exchange rates.

157 US and French officials both stressed this as a unique provision confirming consensus about the bank's economic goals, although Attali mentioned his continuing discomfort with the formality of the 60/40 requirement. See "Industrial Nations to Create Bank to Aid Eastern Europe", New York Times 10 April 1990, p. C 12.

158 "Development Bank for East Bloc to Start Soon, As Meeting Allays US Concerns", Wall Street Journal 10 April 1990 p. A2.

159 Dole, the Senate Republican Leader, and Kasten, ranking Republican on the Senate Appropriations Committee, introduced legislation aiming at an alternative to EBRD, that would have obliged the US to push for the creation of a new financing facility for Eastern Europe at the World Bank. This would bar any Soviet participation. Apart from the Soviet issue, Kasten argued that the EBRD would be dominated by "European policy makers who are indifferent if not hostile to growth" and would promote in effect "quasi-socialist economic policy" making CEE more like Mexico, Brazil, and Argentina than like South Korea and Taiwan. "US Role in Aid Bank Draws Fire", New York Times, 12 April 1990 p. C 1,2; Kasten letter to editor of New York Times, 22 April 1990. Lane Kirkland (President of AFL-CIO) also opposed publicly US participation in the bank at this time.

160 See "Mitterand's East Bank", Wall Street Journal 6 April 1990. The Journal attacked the 60/40 provision as "a distinction without a difference", arguing that the EBRD could no more successful in reaching the productive private sector than the World Bank had been in its directed credit program of lending to private enterprise through state-run development banks. The Journal pointed out that around 50% of directed credit loans were in arrears and that "if the record of the World Bank is any guide, an EEDB [East European Development Bank] would help preserve statism".

161 Edward Hudgins of the Heritage Foundation cited the record of West European behavior in other IFIs as evidence for his assertion that "a bank controlled by

Western European countries with mixed socialist-market economies cannot be expected to promote the complete abandonment of socialism in favor of maximum freedom for the people of Eastern Europe." Even EBRD supporter Congressman John J. LaFalce conceded the Wall Street Journal editors' arguments about on-lending through state development institutions, and worried that the 60/40 provision would prove specious. Mulford answered that both Treasury and EBRD officials had given serious attention to this problem but offered no specific solutions. Proposed US Participation in the European Bank for Reconstruction and Development, and Update on Exchange Rate Report, Hearing before the Subcommittee on International Development, Finance, and Trade, and Monetary Policy of the Committee on Banking, Finance, and Urban Affairs; House, 101 Congress, 2nd Session, 9 May 1990, p. 47, p. 10.

162 Proposed US Participation in the European Bank for Reconstruction and Development, and Update on Exchange Rate Report, 9 May 1990 p. 2.

163 This was part of a log-roll deal that also re-negotiated IMF shares, bringing Japan up to number 2 along with Germany, while Britain and France shared number 4. "Britain and France Resolve Dispute Over IMF Rankings", Financial Times, 8 May 1990, p. 1. The Dutch were singularly rankled by this deal, since they had been promoting their former finance minister Onno Ruding as a candidate for EBRD President. For a short period of time during the third week of May the Netherlands and six other small EC states blocked through the Council of Ministers approval of the Community's participation in EBRD, to display their anger over this point. Interview with PHARE official in Brussels, June 1990.

164 Interview with US Federal Reserve Official, December 1990; "Frenchman Head of New Aid Bank", New York Times 21 May 1990, p. C.4. The Dutch Government expressed its continuing pique by sending the director of the Treasury, Cees Maas, rather than a ministerial-rank official to the event. "Mitterand Sees Bank Having a Leading Role", Financial Times 30 May 1990, p. 2.

165 "Mitterand Sees Bank Having Leading Role", Financial Times 30 May 1990 p. 2; "A New Bank Plans East European Aid", New York Times 30 May 1990 p. A8.

166 Brady was at pains to point out that Soviet participation in the bank amounted to a "net zero" since Moscow could only borrow up to its own hard-currency contribution. "A New Bank Plans East European Aid", New York Times 30 May 1990, p. A8.

167 For Attali's view, see "The Bank of Europe's Post Cold War Program", speech delivered at Bretton Woods Committee, 22 Sept. 1990; reprinted in Harvard International Review 13, Fall 1990, p. 8-11.

168 In its 1991 Development Report the World Bank develops several indices of macroeconomic distortion (trade restrictiveness, foreign exchange premium, real interest rate, and fiscal deficit) and plots the rate of return of 1200 financed projects against those indices. The results are striking: the return on projects is clearly and substantially dependent on macroeconomic policy. The correlation holds for all types of projects public and private, across all different sectors, etc.

169 The IFC's mandate is to lend to the private sector but not specifically to SME. In practice, the IFC has had difficulty identifying bankable SME projects, particularly those not dependent on import protection or already funded by other sources of capital. In many cases, IFC loans have gone toward large scale, sometimes government-assisted projects, heavily oriented toward the export sectors. For this reason, the corporation has been criticized for duplicating or crowding out private investors. See IFC Discussion Paper #5, "The Development Contribution of IFC Operations", Washington DC, The World Bank, 1989.

170 That is, the development of new small businesses under the direction of private citizen entrepreneurs was thought to reinforce the political foundations of democracy, even as the economies of these countries as a whole suffered the traumas of transition.

171 "European Bank for Reconstruction and Development", document issued by

the bank to private sector institutions, 5 September 1990. A bank official connected with finance told me (Interview, June 1990) that fashioning a corporate culture and fitting incentives that would favor appropriately risky investments was understood to be a particularly important concern, because the natural tendencies (given the EBRD's funding structure and its desire to retain a Triple A credit rating on international capital markets) were to do otherwise.

172 The stated rationale for this was to maximize the speed with which the Bank could act. Interview with US Federal Reserve Official, December 1990; Interview with US State Department Official in Washington, December 1990; "Shareholders in EBRD Call on Attali to Rethink", Financial Times 30 July 1990, p. 1.

173 The Economist 28 July 1990, p. 42; "US May Not Support East Europe Aid Bank", New York Times 4 August 1990, p. 18. The US continued to press this point. At ceremonies inaugurating the Bank in April 1991, Treasury Secretary Brady went out of his way to say that "we do not view the activity of the board as an advisory one but instead as a critical element of the bank's operations". An unidentified "senior Treasury official" later said Brady meant that it was the shareholders, represented by the board of directors, who would determine the policy of the bank; and that it was the job of management to carry out those policies. Financial Times 17 April 1991.

174 "UK Economist is First Top Recruit to EBRD", Financial Times 18 September 1990, p. 1; "Attali Foresees Two Years of Loss for EBRD", Financial Times 25 October 1990, p. 2.

175 "The European Bank for Reconstruction and Development", document issued by the bank to private sector institutions, 5 Sept. 1990, p. 3 (my emphasis). This document also mentions that the EBRD would play a part in encouraging the development of capital markets and would advice on regulatory and financial restructuring, but its thrust was clearly elsewhere.

176 Another argument against moving quickly to open branch offices was that if

there turned out to be relatively few good bankable projects, the existence of such offices would create incentives for inappropriate lending. The US in particular wanted to see a clear lending policy and business plan for the EBRD in place and operating before contemplating branch offices. American officials expressed a preference for the IFC model of Enterprise Funds, where IFC regional missions work in collaboration with local banks to co-finance projects that are mostly evaluated and administered by the local institution, with some supervision by IFC personnel. Interview with US State Department Official in Brussels, June 1990; US NSC Official, December 1990.

177 It would have been troubling if the EBRD ended up holding a substantial portion of its subscribed funds in US Treasury Bills or other financial instruments, for lack of suitable projects to lend to. I thank Catherine L. Mann for helpful discussion on this point.

178 See for example "The European Bank for Reconstruction and Development", Policy Focus No. 3, Overseas Development Council, Washington DC, June 1990.

179 "World Bank to Play Reduced Role in E. Europe", Financial Times 6 July 1990, p. 2. The World Bank announced that in Fiscal year ending 30 June 1990 it had sent $1.84 billion in loans to E. Europe; over the next three years it planned to send between $2 and $2.5 billion annually. For additional data, see figure 1. Note that the EBRD with an initial capitalization of $12 billion could lend easily as much as $2 billion annually, making it as large a player as the World Bank.

180 Another possibility was that CEE states would prefer to borrow from the BWIs to avoid EBRD's political conditionality; or that the EBRD would have to compete de facto with more lenient economic terms.

181 World Bank officials in the European Department, for example, saw a major threat for CEE countries in backsliding not from political reform per se but from economic reform as those reforms started to bite. They argued that the World Bank could play an important role here in policy lending, macro-economic support, and

assistance with currency stabilization managed principally by the IMF. The EBRD, in their view, should focus on micro questions, particularly lending to private enterprises. At the same time, they admitted that there had yet been few formal meetings with EBRD officials to discuss coordination issues. Personal Communication with World Bank officials, December 1990.

182 It was further diminished when the G-7, meeting in Houston in July 1990, tasked the World Bank, the IMF, the OECD, and the EBRD to prepare together a large scale study of the Soviet economy, that would be completed in the late autumn. The IMF not the EBRD was put in charge of coordinating this study.

183 Some of this could be attributed to "external shocks", notably the continuing recession in the West and the massive contraction of trade within the former CMEA provoked by the shift to hard currency clearing arrangements at the start of 1991. Domestically, enterprise reform and privatization programs were proceeding reasonably well for existing small businesses but much more slowly than expected for medium size and larger firms, with negative consequences for the ability to attract foreign investment.

184 "Transition", May 1991 Vol 2 No. 5 p. 7. Socialist Economies Reform Unit, World Bank.

185 Susan Collins and Dani Rodrik, Eastern Europe and The Soviet Union in the World Economy, Institute for International Economics, 1991, Appendix C (pp. 141 - 151).

186 "Operational Challenges and Priorities: Initial Orientations", EBRD, April 1991, p. 9. Germany and Austria were the most prominent sources of investment in almost all major sectors.

187 Notable exceptions were several large deals (involving Volkswagen, Suzuki, etc.) in the automobile industry, which appeared mainly to be pre-emptive moves aimed at gaining market share. Foreign investors showed very little interest in support industries and services.

[188] Eastern Europe and the Soviet Union in the World Economy, Appendix C.

[189] Communication with US State Department Official in Washington, March 1991; Communication with US Treasury Department Official, March 1991. A Hungarian representative attending the meeting complained, for example, that the EBRD could do little to promote the most needed macro-economic reforms so long as it was barred from policy lending. The Economist 2 February 1991.

[190] The April 1991 "white paper" issued by the bank in connection with its formal inauguration set out a view that reflected the modified rationale. It stressed the need for the Bank to focus on "basic market economy building blocks" that "will necessitate difficult and time-consuming preparatory steps, essential for the development of the human and institutional base" of a market. "Operational Challenges and Priorities: Initial Orientations", European Bank for Reconstruction and Development, April 1991.

[191] "Operational Challenges and Priorities: Initial Orientations", EBRD, April 1991, p. 16, 17.

[192] Interview with EBRD official, June 1991. The principle behind B-O-T (Build, Operate, Transfer) is that a private concern or consortium constructs an infrastructure-related project and is granted a concession for a period of years, after which the project is transferred to the host government. The first major deal of this kind was being discussed with the Hungarian Government, for a motorway along the major commercial and tourist route between Budapest, Northern Yugoslavia, and Trieste. Both the EBRD and the EIB were considering co-financing this project, estimated to cost about $330 million, through a 20 - 50 year BOT scheme with private Western corporations based in France and the US. Financial Times 29 August 1991 p. 4.

[193] For comparison, the World Bank committed $270 million to telecommunications in the region during 1991; the EIB about $200 million.

[194] I thank an EBRD official in the Merchant Banking Department for helpful

discussions on this point; June 1991.

195 Congresswoman Nancy Pelosi (testimony in Proposed US Participation in the European Bank for Reconstruction and Development, and Update on Exchange Rate Report, Hearing before the Subcommittee on International Development, Finance, and Trade, and Monetary Policy; Committee on Banking, Finance, and Urban Affairs, House, 101 Congress, 2nd session, 9 May 1990) held out the EBRD's commitment to political conditionality and to the development of the private sector as an exemplar and called for greater "symmetry"on the part of other MDBs and particularly the World Bank. Officials from the US Treasury apparently used similar arguments to press the World Bank on the private sector lending issue during the mild controversy of Spring 1991. Interview with EBRD official, June 91.

196 If multilateral institutions were to be involved at all the US preferred the IMF and World Bank, where the US government retained at least primus inter pares influence.

197 This is an extremely brief discussion which I intend to follow up on later in another paper.

198 This reflected in part much-publicized concern over the fate of the Soviet Union's nuclear arsenal, as well as other (more realistic and likely, if less apocalyptic) possible consequences.

199 Interview with EC Official, DG-1 June 1990.

200 A typical argument heard in the early months of 1990 was that the US government had no business spending American taxpayers' money to finance reform in a country still spending upwards of 15% of its GNP on military capabilities, still deployed largely in opposition to US interests. See, for example, "Another Economic Development Bank is Forming in Europe, But Is It Needed?", Wall Street Journal 6 April 1990, p. A 11.

201 The German government in particular was reported to be "still smarting from the pressure exerted by the US to make sure that the Soviet Union would not be able

to borrow from the new European Bank more than the membership capital it puts in". "EC Aid to Moscow Should Be Considered Carefully, Says Hurd", Financial Times 19 June 1990, p. 3.

202 The loan was made for general balance of payments financing, not import financing as most previous German loans had been. The terms included a six year grace period on payments and an interest rate substantially below commercial rates. "Bonn Go- Ahead for Loan to Moscow", Financial Times 22 June 1990; "Bonn to Prop Up Kremlin Reforms With $3 Billion Loan Guarantee", New York Times 23 June 1990, p. 1.

203 Ibid; see also "European Leaders Back Kohl's Plea for Soviet Aid", New York Times 27 June 1990 p. A1.

204 The Economist 30 June 1990 p. 48.

205 "Three Key Economic Issues Undecided as Meeting Ends", New York Times 12 July 1990 p. A 10; "G-7 Compromises Over Soviet Aid", Financial Times 12 July 1990 p. 6. During the fall of 1990 substantial aid did flow through bilateral channels: for example, Italy offered nearly 7200 billion lira in various credits; Spain a $1.5 billion line of export credit; France a $1 billion line of credit. See Financial Times 19 October 1990 p. 4; "Gorbachev Sees Some Signs that Iraq May Reconsider Its Position", New York Times 28 October 1990 p. 4; "Gorbachev, In France, Says His Envoy Found Signs of Shift by Iraq", 30 October 1990, p. 7; see also "Japan to Consider Soviet Aid", Financial Times 16 November 1990 p. 2; "Canada Weighs Aid to USSR", New York Times 19 November 1990 p. C3.

206 See "IMF Leads Moscow Delegation", Financial Times 27 July 1990, p. 2; Financial Times 19 October90 p. 20. The IMF coordinated the study, with each of the four institutions taking responsibility for specific areas of the economy. The EBRD surveyed the role of information, the distribution system, and the transport and telecommunication sectors. Transition, Volume 2 No. 1 January 1991, p. 4. The final report was later published under the title The Economy of the USSR.

[207] See Financial Times 12 June 1991. Referring to the possibility of rescinding or at least relaxing the constraints Attali said "this decision can be taken at any time by the board of the bank in order to improve the capacity of the bank to act...We can only welcome any green light to go more quickly." Financial Times 17 June 1991. Senior Bank officials told me in interviews about a week earlier that "the restrictions could be lifted in a minute" and should be (although in reality the process would not have been so easy).

[208] The Economist 10 August 1991, p. 41.

[209] Prior to the summit the French President wrote to his G- 7 partners arguing that the West should make a small but symbollically important gesture in support of Gorbachev's renewed reform efforts by lifting the ceiling at EBRD. Financial Times 15 July 1991 p. 1. At London Mitterand proposed simply that the Soviet Union be allowed to borrow more than its paid-in capital; Mulroney proposed specifically that Moscow be permitted to borrow up to 15% of the bank's capital. New York Times 16 July 1991 p. 4. The German Government, while generally supporting greater Western aid to Moscow, did not make the EBRD ceiling a priority issue. Financial Times 16 July 1990, p. 4.

[210] See in particular the report of Mitterand's letter in Financial Times 15 July 1991, p. 1.

[211] The Bank participated in only two projects in the Soviet Union during 1991, an enhanced digital telecommunications network and a drilling venture in Siberia, with a total commitment of about 15 million ecu. The EBRD's legal obligation to observe "sound banking principles" and the 60/40 provision would have continued to limit its exposure in the Soviet Union. In a series of conversations with bank officials (both merchant and development banking) in September 1991 I found deep skepticism about economic opportunities in the Soviet Union along with a strong sense that the new bank's limited resources ought to be aimed carefully at countries and sectors that had taken the steps of reform necessary to make projects viable.

There was almost no interest in funding, for political purposes, so called "demonstration projects" that could not be shown economically sound.

212 At the end of January 1992.

213 The region is, for example, rich in natural resources although much of that potential wealth in located in remote regions and is today prohibitively expensive to extract. Developments in technology or in the world economy (including changes in the price of energy) could, however, render extraction of resources economic at some point in the future. I thank several officials in Merchant Banking department of EBRD for helpful discussions on this point.

214 At the time of writing 11 of the 12 had indicated that they wished to accept membership, with Georgia's acceptance pending. Of the former Soviet Union's 60,000 shares, the Russian Federation took 40,000 and inherited its own seat on the board of directors. Other states, like the smaller founding members of the bank, would have to share directorships, and they split up the remaining 20,000 shares among themselves according to terms negotiated with the Bank. Japan dissented from this arrangement, on technical grounds.

215There are a number of reasons. The EBRD lacks the personnel resources to expand greatly its operations in this unfamiliar territory over the short term. There remains a less-clear political justification for operating in several of the ex-Soviet republics, that I expect will inhibit management from proposing to the Board of Directors many actual projects. And as I discuss in the text, EBRD's role as project financier will be constrained in this region unless and until macroeconomic reform proceeds. For the present, the ex-republics of the Soviet Union will deal mainly with the IMF in setting up the pre-conditions for a market economy.

216 I explore later in this section important implications for what kinds of theoretical work can be done with institutionalist arguments. Note, however, that the possible error terms in the "realist" story are in fact large. (Thanks to Raymond Vernon for discussions on this point)

217 That might have been different, for example, if events in the Soviet Union had gone differently and a serious threat to the new-found independence of CEE states had arisen from a revanchist Soviet state. In the case of such a clearly defined shared aversion, the shadow of a new cold war would probably have provided sufficient political and intellectual rationale for Western cooperation, likely led by the US, in aiding CEE.

218 For example, an agency credit line of $50 million dollars was concluded with Societe Generale, to make loans starting at $250,000 to SMEs, via Societe Generale's subsidiaries, branches, and affiliates in countries of operations. In this deal, local banks will screen, structure, perform credit analysis, execute and supervise loans, under guidelines agreed between EBRD and Societe Generale. Initially, the EBRD will approve individually each transaction.

219 See for example "Osteuropabank bemuht sich um deutsche Mitarbeiter", Suddeutsche Zeitung, 2 April 1992. This article states that Germans are poorly represented in top jobs at the Bank but notes that this may be due in part to a lack of interest in careers with international organizations shown by Germans, and the high cost for Germans of living in London. It also notes that Attali has in fact been trying to recruit Germans particularly for several important positions and that German Finance Minister Theo Waigel will be nominated as Chairman of the EBRD Board of Governors in April. It mentions also that the EBRD is poised to announce a series of projects involving German firms and banks.

220 Attali, for example, in an interview given to Japanese journalists in April, said he will propose to the G-7 that the EBRD be permitted to open a "soft-loan" window that could make very long term loans at minimal interest rates for certain infrastructure projects and for military conversion in the ex-Soviet Union. This idea was broached at the Bank's first annual meeting in April 1992 and received poorly by the major member states. If the EBRD is eventually granted this request (and I believe it doubtful, since the US in particular is certain to argue that if there is to be

any such facility it would be World Bank territory) it would have to be handled quite selectively and carefully.

221 See for example "EBRD Wins Credibility With A Hard-Nosed Approach", Financial Times 31 March 1992.

222 President Bush's unilateral declarations on tactical nuclear weapons made in late September 1991 cut in the same direction. For details of some of the current plans and projections see my "Does NATO Have a Future?", in Beverly Crawford, ed., The Future of European Security, Berkeley: Institute of International Studies, 1992.

223 I do not mean here to say that NATO per se will cease to exist, only that the NATO that we knew -- with predominant US power and decision making responsibility -- is coming gradually to an end. I discuss the meaning of multilateralism in NATO in "Shaping the Postwar Balance of Power", International Organization 46 Summer 1992.

224 Baker contrasts this with "insularity", inward-looking applications of shared cultural values which focus mostly on the rights of individuals within each state but do not provide sufficient grounds for externally-oriented cooperation. Of course, the old Atlanticism had 1 principal outward-oriented task: defense against the Soviet threat, which is probably now obsolete. See "The Euro-Atlantic Architecture: From West to East", speech delivered by Secretary Baker to the Aspen Institute, Berlin, 18 June 1991, reprinted in US Department of State Dispatch Vol. 2, No. 25. Further European integration within the EC is compatible with this vision: the US supports European integration in Baker's view "in the expectation that a European union will assume a place as a responsible leader", an outward-oriented body that has a foreign policy presence generally in partnership with the US.

225 The argument about legitimacy and power relationships is drawn from Blainey, Causes of War.

226 "Procedures to Implement the Political Aspects of the Mandate of the EBRD", approved by the Board on 28 May 1991.

227 The document notes of the bank's charter that "references to human rights are in fact found in the Preamble, although not in the Agreement itself. This drafting choice was deliberate".

228 For example, the document notes that the bank might encourage public participation and consultation in the planning of infrastructure projects; it might try to facilitate the establishment of consumer protection bodies.

229 Stephen Krasner, ed. International Regimes. Ithaca, NY: Cornell University Press, 1983.

230 Both theoretically and empirically, in my view. They also inspired valuable criticism, mostly from realists who continued to argue that power explanations, with states' interests defined exogenously, did the bulk of the work and that the study of institutions was distracting.

231 Robert Keohane, "International Institutions: Two Approaches", International Studies Quarterly 32 December 1988.

232 James A. Caporaso, "International Relations Theory and Multilateralism: The Search for Foundations," International Organization 46 Summer 1992. I thank James Caporaso in addition for helpful discussions on this subject. Ikenberry, Lake, and Mastanduno offer a related analysis in "Introduction", International Organization 42 Winter 1988.

233 By strong criteria I mean those that are independent and generalizable. Transaction cost arguments, for example, are relatively strong. There are a number of candidates for weaker criteria, which probably do not deserve to be labelled independent variables with predictive power. I do not dispute the desirability of the second kind of explanation; quite the contrary. I simply prefer that it not try to hide its true nature.

234 Ernst B. Haas, "Why Collaborate? Issue-Linkage and International Regimes,"

World Politics 32 Spring 1980. Reflectivists would mostly reject this starkly economistic comparison of utilities.

235 Economists and economic historians have recently re-invigorated this style of argument, with greater precision and the adept use of formal modelling techniques. See for prominent recent examples Paul David, "Clio and the Economics of QWERTY," American Economic Review Proceedings 75, 1985, pp. 332 - 7; W. Brian Arthur, "Competing Technologies, Increasing Returns, and Lock-In By Historical Events," The Economic Journal 99 March 1989, pp. 116 - 131; Paul David and J. Bunn, "The Economics of Gateway Technologies and Network Evolution: Lessons from Electricity Supply History," Paper 119, Center for Economic Policy Research, Stanford University, 1987.

The Minda de Gunzburg Center for European Studies

The Minda de Gunzburg Center for European Studies is an interdisciplinary program organized within the Harvard Faculty of Arts and Sciences and designed to promote the study of Europe. The Center's governing committees represent the major social science departments at Harvard and the Massachusetts Institute of Technology.

Since its establishment in 1969, the Center has tried to orient students towards questions that have been neglected both about past developments in eighteenth- and nineteenth-century European societies and about the present. The Center's approach is comparative and interdisciplinary, with a strong emphasis on the historical and cultural sources which shape a country's political and economic policies and social structures. Major interests of Center members include elements common to industrial societies: the role of the state in the political economy of each country, political behavior, social movements, parties and elections, trade unions, intellectuals, labor markets and the crisis of industrialization, science policy, and the interconnections between a country's culture and politics.

For a complete list of Center publications (Working Paper Series, Program for the Study of Germany and Europe Working Paper Series, Program on Central and Eastern Europe Working Paper Series, and *French Politics and Society*, a quarterly journal) please contact the Publications Department, 27 Kirkland St, Cambridge MA 02138. Additional copies can be purchased for $4. A monthly calendar of events at the Center is also available at no cost.