The EBRD as the Indispensable Multilateral Development Bank

Personal Foreword

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It is a big claim to call the multilateral development bank that I have had the honour to lead for eight years “indispensable”. I usually recoil when I hear words like “indispensable” or “unique” or “exceptional”. But this volume, the first of two, a history of the European Bank for Reconstruction and Development, written by my former EBRD colleague, Andrew Kilpatrick, will, I trust, convince readers that this is not a fanciful claim.

The book is not an official history. It contains Andrew’s views on the events and themes in the life of the European Bank for Reconstruction and Development (EBRD or the Bank) that, from my vantage point, show clearly how the Bank was a pioneer in the world of international development.

The book is timely. On 29 May 1990, only months after the fall of the Berlin Wall, the Agreement Establishing the European Bank for Reconstruction and Development was signed by its then 42 shareholders from around the world. As we mark the 30th anniversary of that historic day, it is worth reflecting on what made the EBRD so instrumental for the transformation of so many emerging markets, and what makes it vital for tackling today’s global challenges.

This volume charts the history of the Bank from its very beginnings to the days before the global financial crisis, when it briefly seemed that EBRD’s work was nearly done, at least in Central Europe. The second volume, covering the period from the crisis of 2007–2008 to more recent days, will be published ahead of the Bank’s 30th anniversary since the start of operations in 1991—only one year after the international community agreed to its creation.
In this foreword, I give my personal take on why I believe the EBRD has been and continues to be the indispensable institution in the multilateral development bank (MDB) system. At its heart is a story of an MDB that seeks to move with the times, to climb the next peak and not just admire the one it scaled earlier. In short, to use its business model to be relevant to today’s and tomorrow’s challenges.

**System Change**

All other MDBs have the noble purpose of supporting the economic development of poorer nations. The EBRD, born at the end of the Cold War, has the unique mandate to foster system change: to support the transition of centrally planned countries to market economies, and to apply this purpose in countries that are committed to multi-party democracy and political pluralism. This is the most ideological statement in the founding articles of any MDB, a clear commitment by its owners that the EBRD should help bring about system change in the countries where it operates.

What did this transition to market economies mean? It meant, and still does mean, using the EBRD’s investments to grow the private sector, which had been suppressed under central planning. It meant a focus on ensuring the Bank’s investments helped make those economies more competitive.

Over time, the Bank realised that the narrow definition of the economic transition journey needed to change. Citizens now want much more from their markets than mere competitiveness. And the EBRD moved with the times. Today, the EBRD defines successful market economies as having six qualities: competitive, green, well-governed, inclusive, integrated and resilient. Each EBRD investment today must feature two of those six transition qualities. This modernisation of the concept of a market economy has impacted the debate and approach in the MDB system.

Because of its mandate, the Bank is about more than a change in an economic system. The commitment to pursue its purpose in countries committed to multi-party democracy and political pluralism required attention to the political trajectory in each of those nations. Assessments of how far each of the Bank’s countries of operation have reached on that journey remain to this day a feature of the EBRD’s work.

But, as with economics, so with politics, there has been a modernisa-
tion of the Bank’s approach in four ways in recent years. First, there is now a more systematic approach to that assessment with the use of fourteen criteria to gauge where a country has reached on its democratic political journey. Second, the Bank has moved away from the binary and, frankly, inconsistent judgements of the past about whether a country passed the test of its commitment to the Bank’s political mandate to a more honest and transparent description of what exactly is happening within the political system of each nation. Third, the Bank has placed much more emphasis in recent years on not just politics, but also on questions of political economy; for example, where does power reside and how do major decisions get made? And fourth, it has used this modernised political analysis to help shape its investments and policy work, at regional and national levels, and in its engagement with the leaders of the Bank’s countries of operations. These considerations around a political system have sometimes led the Bank to modulate the volume and focus of its lending in some countries.

Such political analysis is invaluable to the work of the EBRD. It should be taken up by other MDBs to inform their work beyond the safe haven of economic governance.

System Change for What Purpose?

Over time, the EBRD recognised that economic system change alone—however important and historic—is not an outcome that is regarded by citizens today as valuable in its own right. So the EBRD recast the concept of a modern market economy at the time when many of the Bank’s shareholders, in recipient and non-recipient countries, were questioning the utility of free markets and the associated globalisation of the world economy. To paraphrase the Monty Python joke about the Romans, many citizens asked: what has the market economy ever done for us? Governments increasingly realised: the modern market must deliver outcomes that are valuable to people today.

Cue the Sustainable Development Goals (SDGs), the COP21 agreement on climate change, and the 2030 Agenda for Development. The SDGs are, in my view, the best description of the outcomes that people of all nations want to see their economic and political systems deliver for them. In sharp contrast to the old Millennium Development Goals (MDGs), they go beyond a narrow set of outcomes to encompass the near totality of the charac-
After the Berlin Wall

teristics of the development condition. And they define in each area the outcomes we should aim to achieve by 2030.

That is why the EBRD increasingly and more explicitly says that the modern market economies the Bank is seeking to create in its countries of operations should be geared to delivering the SDGs. In the language of the technician, the market economy is the output that must deliver the SDG outcomes if it is a system change that is to retain the support of the citizens of the Bank’s countries of operations.

The What and the How

The clearest expression of what the EBRD does to achieve its mission is the investment project, whether through a loan or an equity stake. The investment operation has been the institution’s successful unit of exchange for nearly thirty years. Each project has been assessed from the Bank’s early days for its additionality (to be undertaken only if the market would not finance the same investment), its bankability (that the operation is structured in a way that is financially sound), and its impact on the transition to the market economy (now measured against the six transition qualities). Some things are eternal in the EBRD, even if the arguments continue to rage over the application of these concepts at project, sector, and regional levels.

But some very important aspects have changed over the years, or are beginning to do so, around the core investment operations of the Bank.

First, while the EBRD continues to aim for a market-based approach to loan pricing, the range of themes and countries with which the Bank is now involved means that grant financing is increasingly required alongside the loan. The grant-intensity of the EBRD’s business model has increased. And the organisation has become very successful at attracting donor funds, including from some of its countries of operations, to provide more “blended” financing of its investments, and to support its growing policy work. This shift in themes and countries and the associated increase in donor funds has made the EBRD more of a “development” bank, albeit one that continues to focus on the private sector.

Second, the EBRD has emerged as the leading promoter among MDBs of local currency financing and the building of local capital markets. It understood early on that clients, particularly SMEs, needed local currency
financing and the removal of foreign exchange risks in these vulnerable markets. And the Bank understood also the importance of building local capital markets, e.g. through the issuing of local currency bonds. Other MDBs know the importance of this, but the degree to which EBRD has followed through and increased its efforts in this area is striking, both in absolute and comparative terms, an indicator of its high risk appetite.

Third, there has been recognition in the Bank that operating through its vertical sectors—financial institutions, infrastructure, energy, natural resources, industry, commerce and agribusiness—alone and through clients of all sizes (from SMEs to corporate and state behemoths, as well as municipalities) would not cut it. The sectoral approach needed an overlay of increasingly important cross-cutting themes to be relevant in today’s world.

The most well-known cross-cutting theme is the EBRD’s contribution to the greening of its countries of operations, starting with the Sustainable Energy Initiative in 2006, which grew into the Sustainable Resource Initiative, and in 2015 became the ground-breaking Green Economy Transition (GET) approach. The GET approach established a target to invest 40 per cent of the Bank’s annual business in the green economy by 2020. With 46 per cent of EBRD’s investments in 2019 already in the green economy area, the EBRD has emerged as the leading player among the MDBs on delivery of the climate change agenda, most especially so in the private sector. The Bank is now gearing up to roll out a further modernised GET approach for the 2021–2025 period.

The Bank has also taken up other cross-cutting themes within its investment operations in recent years—gender, economic inclusion, support for refugees—although there is much further to go on these fronts. In each case, the EBRD has proved wrong those who doubted that these classic development themes could fit with its business model.

Fourth, the Bank has been a hothouse of product innovation over the years. Because of its client facing nature, the EBRD is a more demand-driven MDB than others. The EBRD is not a blue skies innovator; rather, it creates products that are useful for its clients but also meet its mandate. Some examples include credit lines to local banks to be on-lent to SMEs, including for energy efficiency improvements, small-scale renewables and women entrepreneurs; the long-standing and very successful Trade Facilitation Programme; the Bank’s work on green, sustainability and climate resilience bonds; innovative risk products; sub-sovereign loans to municipalities and
commercial finance to improve utilities and local services, including in more remote regions, and the increasingly acclaimed Green Cities programme; or the Equity Participation Fund, where institutional investors can co-invest alongside the EBRD. The Bank also has a unique expertise and mandate in nuclear safety and remediation, managing the Chernobyl New Safe Confinement on behalf of international community and helping decommission nuclear plants in other countries.

Fifth, a major development in recent years, has been the scaling up of the Bank’s policy work. Until recently, the EBRD tended to make forays into policy making with its countries of operations based primarily on its investment operations needs.

That has now changed. The EBRD today has a more systematic approach to policy work at strategic levels (country, sectors, themes), based rightly on the knowledge gained from its many clusters of projects and from its clients. The Bank now actively pursues policy reform in its dialogue with leaders of countries of operations. And it has its own policy products, ranging from country diagnostic studies that precede country strategies to practical investment councils that bring governments together with the private sector to help create the right enabling environment for more investment. Of course, there is more to do on this front: in the best cases, a virtuous circle has been created between more reform leading to more investment, which then begets more reform.

And sixth, while the EBRD was an early believer in a matrix between an HQ (that contains sector teams, risk analysts, economists, and lawyers, among others) and Resident Offices in countries of operation, there has been a clear shift over recent years towards more senior boots on the ground. Some senior management posts and certain skills (such as economists, lawyers, portfolio managers) are now more prevalent in the Resident Offices than, say, a decade ago. This represents the growing need to be closer to the clients—private sector and sovereign—and the greater stress placed on policy dialogue.

Moreover, the EBRD is unusual among the MDBs in having offices in secondary cities as well as in the capitals. These offices outside capitals are focused on providing advisory services to SMEs and have grown very rapidly in number in recent years. They have proved their worth in good times and have been invaluable during the Covid-19 crisis in providing information about the impact on clients and how best to support them.

In short, the business model of the EBRD retains the original pillar of the investment operation at its heart but the foundations have been strength-
ened over the years to ensure the edifice is even more responsive to today’s development challenges.

The All-Weather Bank

And the Bank has shown it can respond rapidly and successfully to changes of geo-political, financial, economic and pandemic storms.

As I write this, the EBRD is delivering its operational response to the economic crisis caused by the Covid-19 pandemic that has led to government mandated lock downs and a contraction of economic output. The latest economic forecasts for the Bank’s countries of operations make depressing reading. Sharp recoveries are possible, provided lock downs are eased soon and economies (some of which are dependent on tourism and remittances, some on global value chains, and some on commodity prices) can return to some sense of a normalcy. For the EBRD, it has been imperative to deliver liquidity to clients, arrange payment deferrals and restructurings, increase trade finance, and ensure vital infrastructure and services are not disrupted. In short, the Bank’s response is to help ensure a liquidity crisis does not become one of solvency for its clients. In true EBRD fashion, it was the first MDB to have its “Solidarity Package” approved by its shareholders and investment levels so far this year have outstripped all previous years. And it has done all this with staff working from home and managing their lock-down lives (such as providing home schooling and looking after elderly family members) alongside work.

That the EBRD has done so well in today’s crisis—the most difficult the EBRD has ever had to face—is almost certainly because the Bank is no stranger to having to respond to crises over its thirty years. It responded fast and decisively to the break-up of countries (the USSR and Yugoslavia), geo-political tensions (for example, between Russia and Georgia and Russia and Ukraine), financial and economic crises (in Russia in the late 1990s), across its regions in 2007–2008 (which led the Bank to support the recovery of Greece and Cyprus), major regional political convulsions (following the Arab Spring), and after the refugee crisis caused by the war in Syria.

In all of these cases, the Bank has been able to flex its business model and make use of its matrix to respond rapidly and—very importantly—in a tailored way to the problem at hand. Rightly, the EBRD receives many plaudits
from its countries of operations (that are of course best able to make comparisons with other MDBs) for its commitment, whatever the weather, and its ability to turn promises into reality very fast.

The Where

This adaptive, all-weather, successful business model has made the EBRD an attractive club. There has been growth of membership and of geographic scope in its operations. The EBRD is the only MDB today—other than the newest kid on the block, the Asian Infrastructure Investment Bank—that has a growing membership of both recipients and non-recipients. The EBRD started life with 42 shareholders, and the break-up of some of the original members added to this number, but more recently it has been its successful operational delivery that has attracted new members and turned some existing ones from non-recipients into recipients.

The EBRD is known as one of the four regional development banks. But it is the only one that has members that are countries of operations in Europe, Asia and Africa, so it is already pan-regional. And while the original intention of the Bank’s shareholders was a temporary institution that would regard its job as done as soon as the former communist countries became market economies, the task has proven more long lasting and the business model relevant to nations that never had centrally planned economies. And the Bank has managed this operational expansion to new geographies with great success.

Today’s EBRD attracts big new players as well as smaller countries. In recent years, China and India became non-recipient members of the EBRD, adding to the G20 contingent of the Bank. So, with the G7 and EU member states retaining a majority of the shareholding, the EBRD today—with 71 shareholders and more expected soon—can truly be called a “global institution with a European heart”.

Future Opportunities and Challenges

That is my case for claiming the EBRD is the indispensable MDB for today and tomorrow. Indeed, the importance of the private sector focused business model to transition and economic development in different geog-
raphies, the shift from the narrow MDGs to the wider SDGs in the international system, and the acknowledged fact that the SDGs cannot be met without a ramping up of private finance and delivery, has led the EBRD to the centre stage in the MDB system.

How to keep it there? What makes an institution stay indispensable?

The first task of the future leadership of the EBRD must be to avoid any tendency to wallow in nostalgia. Indeed, put positively, it must be to seek out the opportunities where the EBRD can make a difference and seize them. And it must also identify challenges honestly and tackle them. That balance between seizing opportunities and tackling challenges gets harder as an organisation grows, when it moves from insurgent to establishment status. The Bank must retain its radical, innovative and agenda-setting character. This is the mind-set opportunity and challenge.

The second is to spot the coming issues and be ready with an EBRD relevant response. That means building on key strengths like the Bank’s work on the green economy. It also means making a much improved offer on equality of opportunity, an area where the operational regions could easily go backwards after Covid-19. And it means tackling new areas which will impact the prospects of our countries of operations, such as the opportunities offered up by digital technology. All three of these themes will, I trust, be at the forefront of EBRD’s 2021–2025 strategy. This is the thematic opportunity and challenge.

There is also the geographic opportunity and challenge. The EBRD has a lot more to offer in the neighbourhood regions of the EU and in Central Asia, and in the poorest EU countries of operations, all the markets where the “marginal euro” of investment and policy advice has the greatest impact. The Bank must scale up further in these countries. At the same time, the EBRD is now much less additional in the advanced EU countries of operations, for which there is plenty of finance available from the local banking systems, domestic public budgets, and from the European Investment Bank and the EU. The Bank’s shareholders need to come together and accept this economic truth and work with management to create an approach and trajectory to graduation of these advanced countries of operations.

There is also a huge geographic opportunity for the EBRD beyond our current region of operations for all the right reasons: not because of the capital available, but to make a real difference to the creation of modern market economies to deliver the SDGs. Every one of EBRD’s geographic expansions
has been successful. It is no secret that I believe the Bank would be just as successful with its private sector model in sub-Saharan Africa. And all the analysis that has been done shows that too. Remember the SDGs will not be achieved without sharp progress in sub-Saharan Africa. It is high time to move from procrastination to decision on geographical expansion in the Bank’s coming five-year strategy.

This is not a zero-sum game. The EBRD has the capital to achieve more than a limited and incremental expansion to sub-Saharan Africa and still scale up in its existing countries of operations. But it would also be good for the Bank, either alone or with other MDBs, to look now—five years on from the Financing for Development conference in Addis Ababa, perhaps at an “Addis 2”—how it can leverage its balance sheet to create additional firepower without requesting a capital increase. I believe in the next couple of decades that further expansion of the Bank’s activities beyond even what is contemplated today will be inevitable and the right thing to pursue. Adding to the Bank’s financing capacity over the next year would therefore be good to put on the table in the coming months.

This is a rich agenda for the future based on the EBRD’s achievements over thirty years. But, in my claim for the EBRD’s indispensability, I skated over one overarching issue: the role of shareholders.

Shareholders of MDBs can either accelerate or be a brake on change. The experience of the EBRD is instructive: the countries of operations, especially those outside the EU, have little voice in terms of shareholding but have consistently been the advocates of the Bank moving with the times; and the non-recipients have oscillated between periods of strong support for moving forward fast (for example, in founding the institution and providing the bulk of its capital, in pursuing four geographical operational expansions, and on the green agenda) and a reluctance in more recent times to face up squarely to and be decisive about compelling questions about the future.

If the EBRD is to move forward and retain the status of being an indispensable MDB, then thoroughgoing governance reform will have to come, to give greater voice to those who best understand today’s problems of transition and development—the countries of operations themselves—and so can help the immensely talented management and staff ensure that the Bank remains match-fit for the future.

It has been a privilege to lead the EBRD for eight years. I leave the Bank knowing that it is a great institution. It has done so much to shape the tran-
sition and development landscape, to invest in supporting people to have better lives than would have been possible without the work of the Bank. And it is capable—with the right support from its shareholders—of doing so much more in the years ahead.

Sir Suma Chakrabarti
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