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IN FOCUS

January 30, 2020

European Bank for Reconstruction and Development (EBRD)

The European Bank for Reconstruction and Development (EBRD), the first international financial institution of post-Cold War Europe, was founded in 1991 to ease the path of the former communist countries of Central and Eastern Europe (CEE) and the former Soviet Union from planned to free-market economies. Its geographic area has expanded over time and, today, the EBRD finances projects in 37 countries throughout Europe, the Middle East, and Central Asia. In total, the EBRD has 69 member countries. The United States is a founding member of the EBRD and is the single largest shareholder with a 10% share of the Bank's capital. U.S. membership in the EBRD is authorized by P.L. 101-513, the *European Bank for Reconstruction and Development Act* (22 U.S.C. §290*l* et seq.). On. November 19, 2019, President Trump nominated J. Steven Dowd to be the U.S. Executive Director at the EBRD pending Senate confirmation. His nomination followed the resignation of Judy Shelton, who has been nominated to the Federal Reserve Board.

The EBRD is headquartered in London, England. The Bank was originally designed to function differently than other multilateral development banks (MDBs, see text box) in two key ways: first, it was given a political mandate to support democracy; and second, it was designed to support the development of the private sector in the former communist countries. Changes in Europe over the past two decades have softened both mandates.

The EBRD President is currently Sir Suma Chakrabarti, of the United Kingdom, first elected in 2012. EBRD member countries re-elected Chakrabarti for a second four-year term in 2016. Since its founding in 1991, the EBRD has been headed by nationals of Germany, France, and the United Kingdom. The EBRD's Board of Governors are to elect a new President to succeed Sir Chakrabarti during the EBRD's 29th annual meeting in London in May 2020.

What is a Multilateral Development Bank?

The United States is a member of five major MDBs: the World Bank, African Development Bank (AfDB), Asian Development Bank (AsDB), Inter-American Development Bank (IADB), and EBRD. MDBs are multilateral development institutions that provide financing for projects and policy reform in low-income and developing countries. MDBs borrow in world capital markets at market rates, but the low rates they pay reflect their high credit-worthiness. Because these rates are typically lower than those paid by private borrowers, the banks are, in turn, able to relend this money to their borrowers at lower interest rates. The MDBs' main lending windows are self-financing, generate net income for the institutions, and subsidize MDB concessional lending to the poorest countries. Because the MDBs borrow to finance their lending, their capital (and hence, increases in capital) is leveraged, allowing them to lend more than the amount of their capital. Shareholder capital contributions generally come in two forms: "paid-in capital," which generally requires cash payment to the MDB; and "callable capital," meaning funds that shareholders agree to provide, but only when necessary to avoid a default on a borrowing or payment under a guarantee. Two key factors distinguish MDBs from private sector banks: (1) the MDBs' multilateral shareholding structure and preferred creditor status; and (2) capitalization, including callable capital that is generally much higher than that of commercial lenders. This strong capital position facilitates the AAA rating of these institutions. Thus, MDBs can offer loans to developing countries at rates lower than many private banks.

Political Mandate

Unlike the other MDBs (or the International Monetary Fund, IMF), the EBRD has an explicit political mandate to foster democracies and free-market economies. Article 1 of the EBRD's Articles of Agreements states:

> In contributing to economic progress and reconstruction, the purpose of the Bank shall be to foster the transition towards open market-oriented economies and to promote private and entrepreneurial initiative in the Central and Eastern European countries committed to and applying the principles of multiparty democracy, pluralism and market economics.

In contrast, all of the other major MDBs have Articles asserting their political independence, stating that the MDB 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.

Membership

The EBRD's Articles of Agreement limit membership to European countries, non-European countries that are members of the IMF, the European Community (EC) (now the European Union (EU)), and the European Investment Bank (EIB). The Articles also require that EC members plus the EC and the EIB hold a majority of the institution's capital stock and a majority of the vote. Currently, EU member states, the EU, and the EIB have a combined control of over 63% of the institution's voting power.

EBRD membership has grown in recent years as the Bank has expanded its geographic range. Libya became the EBRD's most recent member in July 2019, marking an expansion of the Bank's presence in the Mediterranean region. Other new members include Egypt, Jordan, Lebanon, Morocco, and Turkey. At the beginning of 2016, China became a member of the EBRD, but has a nominal share (0.096%) of the Bank's capital. In recent years, EBRD management has expressed interest in expanding into sub-Saharan Africa. In May 2019, the Bank's membership agreed to a resolution to begin the process by preparing feasibility studies to be presented at the fall 2020 EBRD annual meeting.

Operations and Select Policy Issues

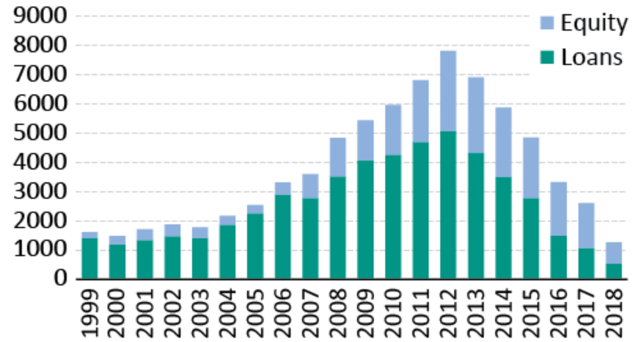
The 2008-2009 global financial crisis spurred a sharp increase in EBRD lending and eventual capital increase, an effect also reflected at the World Bank and other MDBs (see text box). In May 2010, the Board of Governors approved a request from the EBRD's president for a €10 billion ($11.05 billion) increase in authorized capital to €30 billion ($33.15 billion), a 50% rise from 2009 levels. Of the total authorized amount, €6.2 billion ($6.85 billion) is paid-in capital and €23.5 billion ($25.97 billion) is callable capital.

As of 2019, the EBRD has investments worth a total of €9.5 billion ($10.5 billion) in 37 countries, with 70% of its operations outside the EU. For much of the EBRD's history, Russia was the Bank's largest borrower, but its share has declined after the G-7 countries decided to oppose EBRD projects in Russia following its annexation of Ukraine's Crimea region. In July 2014, the EBRD's Board of Directors gave guidance that new investment projects in Russia were unlikely to be approved. Similar action was also taken by G-7 countries at the World Bank, and complemented broader economic and diplomatic sanctions against Russia. Some analysts found EBRD's involvement in Russia controversial even before the crisis in Ukraine, questioning whether Russia had met the democracy and pluralism criteria for EBRD projects.

While the EBRD continues disbursements on older projects, the EBRD's exposure to Russia now accounts for 5.5% of total operating assets, compared to around 26% in 2013 (**Figure 1**). At the same time as it reduced its Russian exposure, the EBRD expanded its lending south into the Balkans, the Caucasus, and the Southeastern Mediterranean (**Figure 2**). In April 2008, Turkey, a founding shareholder of the EBRD, applied to become a recipient country and now accounts for 20% of EBRD operations, despite its status as an upper-middle income country. Moving forward, the EBRD will likely need to develop a more robust strategy to "graduate" high-income member countries. To date, the Czech Republic is the only country that has graduated from EBRD borrowing. As the institution moves beyond its original clientele of the more advanced, early transition economies in Eastern Europe, to countries in North Africa and the Caucasus, it will be a challenge for the EBRD to successfully engage in substantially less democratic countries (such as Egypt) that may be more reluctant to introduce pro-democracy reforms than were the first wave of post-Communist EBRD borrowers.

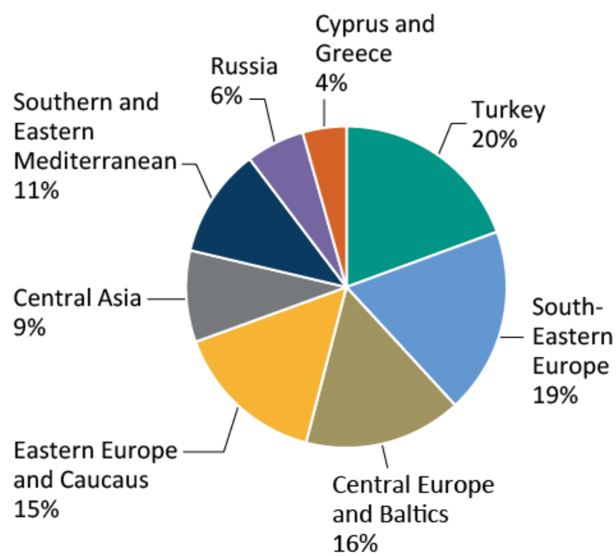
Other relatively new borrowers include Jordan (2013), Morocco (2013), Tunisia (2013), and Lebanon (2017). In May 2017, the EBRD's shareholders also approved engagement in the West Bank and Gaza through an EBRD trust fund for an initial 5-year period. The EBRD's expanded geographic focus also raises questions about its relevance given the existence of other MDB such as the Asian Development Bank and the Islamic Development Bank.

Figure 1. EBRD Operating Assets in Russia, € Millions



Source: CRS, EBRD, Moody's.

Figure 2. EBRD Lending by Region in 2018



Source: EBRD 2018 Annual Review.

Looking Ahead

Over the past 30 years, the EBRD has been an important component of U.S. foreign and economic policy in Eastern Europe and Central Asia. Going forward, the EBRD will likely continue to be an important part of the toolkit for Members of Congress as they consider how to respond to increased Chinese engagement in Central and Southeast Europe as well as democratic back-sliding in Europe. At the same time, Members may also consider if the EBRD's outreach into the constitutional monarchies of North Africa and the Middle East is consistent with its original mandate to facilitate the democratization of Eastern Europe.

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