At the end of the 1980s, communism faltered throughout the former Soviet bloc and in Yugoslavia and Albania. From Silesia to Sakhalin, countries began to make progress in the movement towards democracy and market economies. With this shift came a historic opportunity for international cooperation to fundamentally improve the lives of some four hundred million of the world’s citizens.

Against this backdrop, the European Bank for Reconstruction and Development was created in 1991 to assist the people of the region in their long journey to full integration into the international economy. The EBRD has had a real impact on the transition process and directly on people’s lives in areas as diverse as banking reform, municipal infrastructure and the development of small businesses. From the outset, the EBRD has remained committed to the principle that good laws supported by both well functioning legal systems and enhanced respect for the rule of law are the cornerstones of the region’s future prosperity. The Bank’s ten years of activity in the area of legal reform, which is the focus of this issue of Law in transition, testify to that commitment.

The United Nations welcomes the legal reform work of the EBRD because it champions fundamental human rights and helps “promote social progress and better standards of life in larger freedom” as set out in the preamble to the United Nations Charter. The legal reform work of the EBRD and of the United Nations is mutually reinforcing. While the EBRD focuses on developing the legal rules, institutions and culture on which a vibrant market-oriented economy depends, the United Nations, through the United Nations Development Programme (UNDP), the United Nations Commission on International Trade Law (UNCITRAL) and its other constituent agencies, supports legal and judicial reform projects. Both institutions have profited from a decade of partnership, complementing and supplementing each other in many areas. Indeed, the Agreement Establishing the EBRD envisages such cooperation and recent examples of this are the Bank’s leading role in the reconstruction of Bosnia and Herzegovina and its provision of assistance in Kosovo following the establishment of the United Nations Mission in Kosovo (UNMIK).

The lessons drawn from the EBRD’s legal reform work in the former Yugoslavia is documented in this issue of Law in transition, along with those from the other countries where the Bank works. Of the lessons learned none are more resonant than the pivotal position played by the rule of law and the importance of strong institutions to support it. The rule of law prevails where the law binds government itself; where all citizens achieve equally at law; where government authorities and the judiciary protect the human dignity of all citizens; and where justice is accessible to all. Transparent and fair legislation and predictable enforcement are prerequisites. Governments must be legitimate, held accountable for maintaining order and promoting private sector growth. Without the rule of law nations will founder, peoples will suffer and civil society will be at risk. Indeed, the turbulent events of the past year can only serve to reinforce this message and encourage redoubling of efforts to build independent judiciaries and respect for contracts and property rights as core principles of free societies.

It is often said that those who cannot remember the past are condemned to repeat it. We must all look to lessons of the past as we address challenges of the future. This tenth anniversary edition of Law in transition disseminates the lessons of the EBRD’s legal reform efforts. It should be of particular interest to those who make or influence legal reform policy in the countries where the EBRD operates. I encourage readers, including those in the wider United Nations community, to read this publication and to learn from the rich experience of the EBRD’s legal reform activities over the past ten years.
Process drives success: Key lessons from a decade of legal reform

This article identifies three key lessons for institutions and agencies providing legal reform assistance. It argues that a successful legal reform project is one that adapts internationally accepted principles and standards to the local legal environment, focuses time and resources on implementation and enforcement and, most importantly, works through an open, transparent and inclusive process.
Legal reform is now generally accepted as a necessary component of the development process. While a small number of development agencies have provided legal reform assistance for some time, it is only after the financial crises in East Asia in 1997 and Russia in 1998 that most international financial institutions (IFIs), development agencies and many developing and transition countries themselves have recognised the need to create a sound and effective legal foundation for democratic governments and market economies. Beyond the rhetoric, many international agencies and governments have been using technical assistance to help develop comprehensive legal rules and legal institutions - from creating an independent judiciary and training judges and prosecutors to adopting commercial and financial laws and implementing regulations based on best international practice. This has been a positive step towards committed sustainable development.

As a result, there is now an increasing amount of legal reform taking place in developing countries. While much of the technical assistance provided by donors has led to changes in the legal systems of the recipient countries, not all of this reform can be considered successful. In some instances laws have been developed but not enforced; in other cases donors have been slow to help create or reform the necessary implementing institutions; and in still other cases the “wrong” laws or laws that do not fit in with the recipient country’s existing legal system have been adopted. Unfortunately, to date, there has been little review and analysis of legal reform practice from which to draw lessons to help shape future legal reform efforts.

This article identifies some key themes and practices that could be used to guide ongoing and future legal reform efforts. The article argues that it is essential for IFIs, development agencies and recipient countries to focus more attention on the process of legal reform - how donors and developing countries design and implement legal reform assistance - in order for their assistance to help build effective legal foundations for economic and political development.

The EBRD’s Legal Transition Programme

The EBRD was established in 1991 to help those countries of central and eastern Europe committed to the principles of multiparty democracy, pluralism and market economics, with their transition from command to open market-oriented economies. The Bank was mandated to focus its assistance primarily on the development of the private sector in these countries. The EBRD first became involved in the field of legal reform only a few months after it began operating in April 1991 by bringing together international lawyers and legal experts at a regional seminar to explore ways in which the Bank could promote legal transition in its countries of operations. This was the first time the Bank used donor funding to support legal reform.  


3 Agreement Establishing the EBRD, Article 1.

4 These are grant funds made available to the Bank from its shareholders and others for use in supporting the EBRD’s activities in the region.
The EBRD’s involvement in legal reform has become an integral part of its work, influencing the Bank’s research and analysis, affecting its transition strategies and financial policies and, most directly, assisting with the development of market economies throughout its countries of operations.

The EBRD’s legal transition effort has been centred in its legal department. Over the past decade, the EBRD’s legal reform work has evolved from the development of its Model Law on Secured Transactions and the ad hoc provision of legal assistance to the formation in 1995 of a small, dedicated team of lawyers working full-time on legal reform within the EBRD’s Office of the General Counsel and, most recently, to the development of a more coherent and integrated Legal Transition Programme (LTP) starting at the end of 1997. (See box on previous page for a timeline of the evolution of the EBRD’s legal transition assistance.) Unlike other IFIs, the EBRD’s legal transition assistance is primarily grant based. In addition, the EBRD’s Legal Transition Programme is unique in that it draws directly on the Bank’s experiences as the largest lender and investor to the region’s private sector to ensure that its legal transition assistance is grounded primarily on the views and concerns of the private investment community, increasing both the credibility and practicability of its assistance.

Reflecting the EBRD’s mandate, its legal transition work has focused on developing the key commercial and financial laws and implementing institutions necessary to support private sector enterprises and sound financial transactions. The EBRD’s present legal transition activities focus on the following sectors:

- bankruptcy;
- company law and corporate governance;
- concessions;
- secured transactions; and
- telecommunications.

These sectors have been chosen because of their importance as part of an investment climate supportive of private sector development and because of their close relationship with the EBRD’s investment operations in the region. In each sector, the EBRD promotes the adaptation of international, regional or harmonised legal standards where they exist and designs its legal transition projects to include the creation or improvement of effective implementing and enforcing institutions. For example, working from its Model Law on Secured Transactions, the Bank has developed a set of core principles to guide the development of modern collateral laws and has provided assistance with the creation of registration systems. In the telecommunications sector, the EBRD supports the implementation of the European Union’s directives in accession countries or World Trade Organization commitments in the CIS, and in both regions the Bank has helped create effective, independent regulatory bodies.

With the implementation of the Legal Transition Programme, the Bank organised its legal reform work in each of the sectors listed above around the following four activities:

1) Participating in the development of international legal standards or best practice

The EBRD has worked closely with other IFIs and international organisations to identify and/or develop standards or best practice for international commercial transactions. The EBRD has worked with the World Bank on its Insolvency Initiative, with the Organisation for Economic Cooperation and Development on its Principles of Corporate Governance and with the United Nations Commission on International Trade Law (UNCITRAL) on developing model laws for concessions and insolvency.
2) Assessing the state of legal transition

Since 1995, the EBRD has conducted an annual Legal Indicator Survey of practising lawyers in the region. The Bank surveys lawyers for their perceptions on the extent and effectiveness of the commercial and financial laws in each country. The EBRD has also developed analytical tools to assess the development of laws and legal institutions in each of the five legal sectors. These sector assessments benchmark laws and regulations against international standards and evolving best practices. The results of both the annual Survey and the sector assessments, which are integrated into the Bank’s country strategies and used in its investment risk analyses and policies, are published on the Bank’s Web site and in its legal journal, Law in transition.

3) Legal transition projects

The EBRD designs, develops and implements legal technical assistance projects in the Bank’s countries of operations to support local authorities in establishing investor-friendly legal systems. These projects are initiated only with the support of the government or NGOs, are implemented by EBRD counsel and external consultants, and are supervised jointly by the Bank and the sponsoring government agency. The Bank provides both its own and external experts to advise on specific legal reforms, but the sponsoring government and local specialists draft, adopt and implement the reforms.

4) Outreach and coordination

The Bank promotes legal transition by sharing its own experiences of legal reform and those of other organisations, as well as the ideas of leading legal reform practitioners in Law in transition. The journal is distributed widely throughout the region in English and Russian and is given directly to government officials, parliamentarians, senior judges and lawyers involved in legal reform activities. The Bank conducts an annual legal seminar at each EBRD Annual Meeting where key legal reform issues are presented and debated. The EBRD also collaborates closely and coordinates with other IFIs, international organisations and bilateral assistance providers in implementing legal reform projects and developing policies.

With the implementation of the Legal Transition Programme over the past few years, the EBRD has actively sought to integrate legal reform activities with its investment operations and transition mandate. The EBRD legal reform work has become a part of the Bank’s transition research and analysis, plays a role in setting the Bank’s transition strategies and financial policies and, most directly, helps the Bank promote the development of market economies throughout the transition countries. The mainstreaming of the EBRD’s legal reform activities, however, is an evolving process. While the Bank’s legal reform activities have been generally successful, it has learnt a number of lessons about the legal transition process and, more specifically, about how it, and other legal reform providers, can be more effective in assisting that process.

7 For a description of the results of the Bank’s Legal Indicator Surveys over the past seven years, see, infra., A. Ramasastry, “What local lawyers think: A retrospective on EBRD’s Legal Indicator Surveys” at p. 14.
8 The first of these, “A Regional Survey of Secured Transactions”, can be found on the EBRD’s Web site at www.ebrd.com/st. The Bank should finalise assessments on corporate governance and bankruptcy during the course of 2002.
9 For examples of the EBRD’s legal transition projects see K. Zahariev, “Reforming the legal environment in post-conflict societies: legal and policy aspects of the EBRD’s activities in south-eastern Europe”, Law in transition, p. 39 (Spring 2002); N. Seiler, “The role of the EBRD in promoting sound corporate governance”, Law in transition, p. 26 (Autumn 1999); G. Sanders and D. Arner, “The legal anchoring of sound financial markets”, Law in transition, p. 18 (Spring 1999); see also www.ebrd.com/country/index.htm. The Legal Developments section of each issue of Law in transition contains the latest update on EBRD legal reform projects, (see infra, p. 62).
10 In 2001 the EBRD’s Project Evaluation Department supervised a team of legal and other academics in carrying out a thorough external evaluation of the LTP. The team rated LTP as “successful” in obtaining its objectives and “highly successful” in implementing a number of its activities. For further information, please contact the EBRD’s Project Evaluation Department.
Lesson 1: Benchmarking against international or harmonised principles and standards

One of the key conclusions to come out of the analysis of the East Asian and Russian financial crises was the need to identify or develop international commercial and financial standards that can be used to assess investment climate risk in emerging and developing markets.\(^\text{11}\)

Following the crises, the G-7 asked the World Bank and the International Monetary Fund (IMF) to take the lead in working with other IFIs and international organisations and experts to develop international financial standards. Much of this work has led to the identification of general principles or guidelines for developing laws based on best financial and commercial practice in developed economies rather than specific standards or rules.\(^\text{12}\) Some organisations such as UNCITRAL, however, have taken this process one step further and have begun to prepare legislative guides and model laws based on these internationally accepted principles.\(^\text{13}\)

The EBRD has actively participated in the development of international standards in large part to ensure that these processes take into consideration the concerns of international investors (like the Bank) and the specific conditions and needs of the transition countries. The World Bank and other organisations have gone to great lengths to include emerging market government officials, lawyers and businesses in the process of developing the standards. For example, during the development of the International Principles and Guidelines for Insolvency Systems, the World Bank and regional development banks (including the EBRD) co-hosted regional seminars where draft principles were discussed and debated with a range of regional representatives. Country officials were also given the opportunity to describe their efforts at reforming their commercial and financial legal systems to take account of best international practice. As a result, many of the principles and standards that have been developed to date have been reviewed, analysed and revised to take account of the comments and ideas from the emerging and developing countries.

The G-7 also asked the World Bank and the IMF to lead the effort in benchmarking the financial and commercial systems (primarily laws, regulations and legal institutions) of developing countries against these standards and to use this information to increase the transparency of emerging and developing markets. This benchmarking exercise serves two objectives.

First, it provides international investors with a more standardised and objective assessment of risk across emerging and developing countries, allowing them to make better-informed investment decisions. This additional transparency is also expected to provide the IFIs and international investors with an “early warning” of future financial problems so that corrective action can be taken before problems develop into a crisis.

Second, and more importantly for the legal reform process, by measuring existing legal systems against international standards, benchmarking provides a guide and an incentive for promoting commercial legal reform. By identifying where key commercial and financial laws and legal institutions fall short of internationally accepted principles and best practice, benchmarking provides a roadmap for legal reform donors and leaders to prioritise their reform efforts. Given the fluid nature of private international capital, assessments based on international standards can also create positive legal reform “competition”, as countries try to develop legal systems that attract international capital. Competition for investment capital led Russia (criticised by many investors and organisations for poor corporate governance and weak shareholder protections) to use the OECD’s Principles of Corporate Governance as a guide in developing, with EBRD assistance, its recently-approved Code of Corporate Conduct.\(^\text{14}\) By using and adapting the OECD’s internationally accepted principles, Russia has signalled that it intends to develop an investment climate that meets the expectations of the international investment community.


\(^{13}\) See UNCITRAL, Legislative Guide on Privately Financed Infrastructure Projects (2001). See also, J. Faria, “UNCITRAL Legislative Guide on Privately Financed Infrastructure Projects”, Law in transition, p. 29 (Spring 2001). UNCITRAL is also in the process of developing a legislative guide and model law for insolvency and a legislative guide for secured transactions. See www.uncitral.org/ for more information.

\(^{14}\) The Russian Code can be found at www.rid.ru.
The use of internationally accepted principles and practices brings with it an additional benefit for the legal reform process. A frequent criticism of early legal reform assistance was that it was a way of transplanting Western legal ideas and practices in developing countries. Similar complaints can still be heard today. The use of international principles and standards allows legal reform donors and reformers in transition countries to counter accusations of “legal imperialism”: internationally accepted principles and practices are based on an amalgamation of what works best in a given commercial legal area, not on any one country’s laws. One commentator recommends, “the use of neutral substantive law prescriptions for recipient countries, stripped of their local conceptual and contextual biases, and ideally based on laws that enjoy a reasonably common currency among a number of countries.”

Finally, legal reform providers must guard against the use of international standards devolving into a process of simply translating and adopting those standards directly into the legal system of an emerging market or transition country. Although this seems an appealing prospect to countries eager to prove their worth to international investors (and to please their legal reform beneficiaries), adopting international standards without first adapting them to existing legal norms and practices in an emerging market or transition country brings the real risk of legal reform failure. While most international principles are based on widely-accepted standards and best practice, including practice from the emerging and transition countries, they have not been designed to be enforced or applied by institutions such as courts and regulatory agencies that are themselves weak and still developing. They also have not been designed to fit in with the unique economic, political and legal history that each country must take account of as it undergoes legal reform. As a result, using international standards to guide legal reform efforts should only be seen as the beginning of a reform process that will be led by local officials, local legislative drafters and local experts, with participation from other interested groups.

**Lesson 2: Implementation, implementation, implementation**

Developing and drafting laws is only the start of the legal development process. If legal reform is to encourage the domestic capital accumulation, local financial intermediation and foreign direct investment that are key to economic growth and development, then new commercial and financial laws and regulations must be used by the business and banking community, applied by regulatory agencies and enforced by the judiciary. The EBRD’s early legal surveys and research revealed that the orthodox approach to legal reform, where laws are developed first and implementing institutions strengthened second, needed to be reconfigured, with greater and earlier attention given to implementation and institution building. This revised sequencing of legal reform assistance continues to be supported by the results of the Bank’s annual Legal Indicator Survey. Since 1997 the EBRD Survey has revealed a troublingly consistent “implementation gap” between the extent of new commercial and financial laws and their effective application. This gap runs across all legal sectors covered by the Bank’s LTP and has only recently begun to shrink in the accession countries of central Europe. (The results of the annual Survey are discussed more fully in the article that follows.)

EBRD research has shown the importance of the effective implementation of legal reforms in the economic transition process. This research highlights the fact that effective legal institutions have a much stronger impact on economic variables than the substance of the law. For example, there is evidence that the effectiveness of insolvency laws, rather than their content, is a key determinant of both foreign direct investment and the ratio of domestic bank credit to the private sector. The analysis revealed no correlation between the extent to which insolvency laws approximate international standards and these key economic variables. In a further study, researchers examined the effect of corporate governance on financial development in transition countries. Using a number of different measures for legal effectiveness, including results from the Bank’s Legal Indicator Surveys, these researchers found that the problem of “weak corporate governance in transition...cannot be solved only by even radical improvements in the legal framework.”

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16. This view is not universally accepted. For one, see the use of international principles and standards see A. Perry, “International Economic Organisations and the Modern Law and Development Movement”, in A. Seidman, et. al., eds. Making Law Work, supra note 1.


18. The same holds true for that matter for efforts to transplant without revision any individual country’s laws or regulations.

19. See C. Walsh, supra note 17, at p. 12. (“This thesis suggests that the imposition of foreign market-orientated legal models on indigenous institutions is unlikely to be effective or even wise...”)

20. Based on the EBRD’s 1995 and 1996 Legal Indicator Surveys of investment laws in the region and other research, it has been argued that “institutions responsible for the enforcement of new laws should be strengthened either before or during the time that such new laws are enacted”. J. Taylor and F. April, “Investment Law in transitional Economies”, Parker School Journal of East European Law, Vol. 4, p. 51 (1997). See also J. deLisle, “Lex Americana?: United States Legal Assistance, American Legal Models, and Legal Change in the Post-Communist World and Beyond”, University of Pennsylvania Journal of International Economic Law, vol. 20, p. 179 (1999).


Legal reform projects should explicitly include an implementation component. From helping to create an implementing institution (e.g., registration system, regulatory agency, etc.) to training regulators and judges on the interpretation and enforcement of new laws and regulations, legal reform providers should address implementation head on.

Simply put, “good laws cannot substitute for weak institutions.” Other studies have reached similar conclusions about the positive correlation between effective legal implementation and economic development and investment. Much of this research is relatively new and most donors have only recently begun to increase the implementation and enforcement components of their legal reform assistance packages.

Why did it take so long for legal reform providers to increase their focus on implementation and enforcement issues? First, implementation takes time, and assistance providers (both IFIs and bilateral agencies) do not have a short time horizon within which to work. They must report “successes” back to their shareholders, legislatures and treasuries within a short time frame (often one year or one budget cycle) if they are to continue to receive the funding necessary for further legal reform assistance. Yet it takes time to develop and implement institutions, many of which must be created from the ground up, and to train regulators and judges on how to interpret new laws. Many legal reform providers have not been able to dedicate this time.

Second, implementation costs more. It is expensive to create, staff, and train new regulatory agencies and funded institutions such as the acquis communautaire. See europa.eu.int/comm/enlargement/report2001/index.htm.

Notable exceptions to this lack of large, long-term funding include the legal development or legal reform loans and credits provided by the World Bank to Armenia, Georgia and Russia, as well as the Asian Development Bank’s reform-oriented loans to Pakistan and the Kyrgyz Republic. While some of this funding has been directed at judiciaries and regulatory agencies, it has not been specifically focused on helping to develop and implement commercial legal reforms.

A prime example of this increase in emphasis is the European Commission’s recent decision to commit more of its Phare funding for accession countries towards increasing and improving the administrative capacity of the governments of future member states. The Commission’s annual accession reports have, for a number of years, raised concerns about the lack of institutional and administrative capacity available in accession to implement the acquis communautaire. See europa.eu.int/comm/enlargement/report2001/index.htm.

Because of its specific focus on commercial legal reform and given that the World Bank and others work on improving the legal system generally, the EBRD looks to other legal reform providers to provide assistance with building effective judiciaries and court systems.

As with the development and use of international standards, implementation and institution building have taken on a larger role in legal reform projects supported by IFIs and bilateral agencies following the institutional failures that contributed to the 1997 and 1998 financial crises. The EBRD has included an implementation component in each legal transition project it has supported – from creating pledge registration systems and telecommunications regulatory bodies to training capital market regulators and bankruptcy judges – since 1999. This has meant that the EBRD’s legal transition project budgets have grown from €200,000 or less on average to around €500,000 on average and project timelines have extended from 12-18 months to 24 months or longer. To be effective, the Bank has found that enforcement issues surrounding a proposed law or regulation should be considered and addressed at the early stages of a project, starting with the design and legislative drafting phases. This helps to ensure that new legislation is developed in a way that enhances the usefulness of the law and promotes understanding among those expected to use it.

Legal reform projects should explicitly include an implementation component. From helping to create an implementing institution (e.g., registration system, regulatory agency, etc.) to training regulators and judges on the interpretation and enforcement of new laws and regulations, legal reform providers should address implementation head on. Projects may also include funding to help promote the reform among those businesses, lawyers and other market participants that are intended to use and benefit from the reform. In its capital market projects in the Czech Republic and Russia, the EBRD worked with its transition government counterparts to develop legal transition projects that included implementing regulations and security commission training. The EBRD’s assistance with concession law includes the preparation of a model concession agreement that can help guide government officials who will be applying the law in negotiations with commercial investors.

Emphasising implementation also requires that legal reform providers and local reform leaders extend the reform process in order to monitor the application of new legislation so that any problems in enforcement that can hinder reform effectiveness are identified. Having learned from its continuing involvement in Hungary’s secured transactions reform process (three projects over a period of seven years), the EBRD has now built a monitoring and adjustment phase into its most recent secured transactions projects in the Slovak Republic and FY Yugoslavia. While these monitoring phases have yet to get under way, the EBRD and its government counterparts are involved in ongoing discussions with market participants, registration operators and judges in order to identify and develop solutions to implementation problems as quickly as possible. Institution building is a long-term process; legal reform providers and their transition country counterparts should be prepared to stay involved beyond the drafting of legislation or training of regulators and judges so that they can make any adjustments necessary for legal reform projects to be effectively implemented.
Lesson 3: Legal reform through an open and inclusive process

The primary lesson legal reform donors and their government counterparts can learn, and the most important lesson for the sustainability of effective legal reform over the long term, is the need to develop and nurture a transparent and inclusive legal reform process. Legal reform providers should assist recipient countries in such a way that the countries are able to gain experience with and develop their own sustainable and effective legislative and institutional reform process. The reform process itself should become a focus of legal reform assistance.

What does it mean to develop an open and inclusive reform process? What benefits will such a process bring for the successful development of effective laws and legal institutions that can support a growing market economy?

Building an inclusive legal reform process

The reform process starts with the design of technical assistance. Legal reform providers should design projects with the participation not only of their government counterparts but also a broad spectrum of groups and experts interested in the legislation (including those that will be expected to use, implement and enforce new legislation as discussed above). Prior to initiating a legal reform project, EBRD counsel meet with local lawyers, academics, specialists, market participants, other potential “law users”, implementing agencies and the judiciary in order to get as full a picture as possible of the issues, interests and context within which a specific legal sector is to be reformed. Counsel also meet with representatives of government agencies other than the one requesting the legal reform assistance; reform problems often arise due to a lack of coordination within a government. It is important for legal reform providers to cast a critical eye on the requesting agency’s view of a problem and/or solution by gathering the views of those groups likely to be affected by any change and building such views into the design of the legal assistance.

Likewise, legal reform providers should work with governments to make the legislative drafting process inclusive and transparent. The art of drafting new legislation and regulations is technical and can be done most efficiently and effectively by a small group of local experts assisted by donor-supported external specialists. However, once draft legislation or regulations are prepared, an open reform process requires that they be widely distributed for comment, review and, if necessary, revision. Unfortunately, transition country government and legislative officials are likely to be reluctant to open up the legislative process in this way.

Lawmaking and legal implementation are at the heart of a government’s role in a country; designing and running the legal system are core government functions. As a result, it is likely to be difficult to convince officials of the need to open the legislative process (and, by association, themselves) to comments and possible criticism. Legal reform is inherently a political process with new laws, regulations and implementing institutions capable of changing the balance of power between commercial and financial interests and the government. Therefore, legal reform providers will need to convince government officials that the consensus-building process, which started at the design phase, is necessary to ensure legislative and institutional reforms are more effective. Transition governments need help in realising that by ceding some of their lawmaking role through an inclusive legal reform process they can reach their economic development goals more efficiently.

Along these lines, a working group, consisting of government, judicial, legislative and often private sector experts and specialists, oversees the EBRD’s legal transition projects. Once local drafters have prepared draft legislation or regulations, working group members have an opportunity to review and comment on the drafts. This open process takes place both before and after legislation has been passed to a parliament for consideration and approval. It is at this stage of the legal reform process that those businesses, groups and individuals potentially affected by the draft legislation can test the proposed changes for practicality, efficiency and effectiveness.

32 See J. Simpson and J. Messe, supra note 5, at pp. 22-23.
Once the drafting is complete and new legislation or regulations are adopted, donors and government officials should continue to maintain an open dialogue with those in the commercial and financial sectors who use the new laws, as well as the regulators and judges who apply and enforce them. Monitoring of the reforms should be in addition to assistance provided for implementation. Including the key players in monitoring and reviewing the process conducted by legal reform providers and local reformers ensures that the reform process remains transparent and inclusive and that future revisions to legislation resolve identified problems and are as practical as possible. Maintaining a coalition of “vested interests”, such as those commercial and financial interests affected by a reform, should also help improve implementing institutions as these interests are in the best position to identify problems and suggest specific, effective solutions.33

The EBRD has tried to build an inclusive and transparent legal reform process in most of its recent legal transition projects. In Moldova the Bank specifically solicited comments on a draft secured transactions law from the Moldovan banking association and presented them to the government before the draft was submitted to parliament. However, this project stalled due to indecision over its implementation. An ongoing concessions law project in Slovenia was designed and is being implemented with the involvement of ministries other than the Ministry of Finance, which is sponsoring the reform to ensure that the framework concession law will be useful for a variety of commercial sectors. When implementing corporate governance projects with securities commissions and ministries of finance, the Bank has worked to ensure that self-regulating organisations such as brokerage associations and other capital market participants are involved in the project directly and, at a minimum, are given an opportunity to comment on proposed laws and regulations. In Russia, the Federal Commission for the Securities Market (FCSM) helped create a number of groups of external experts and market participants who were consulted when developing Russia’s new Code of Corporate Conduct. Their participation was important given that many capital market and corporate governance rules are intended to be self-enforcing and, therefore, must be fully understood and internalised by these groups if they are to be effective.

Benefits of an inclusive process

An open and transparent legal reform process provides a number of benefits that can increase the ultimate effectiveness of reform, bringing with it the expected improvements in economic growth and development. These benefits arise from the fact that the intended beneficiaries, users and enforcers of new laws and institutions, can become involved in their development and implementation. Among the benefits that such a process provides are:

1) Aids adaptation over adoption.

Recent research has shown that the way a law is transplanted can impact on its effectiveness and will have an indirect effect on economic development. According to this research, transplanted laws that are adapted to local legal norms and conditions were found to be more effective.34 Such adapted laws are more likely to arise out of a legal reform process that is led primarily by local legislative drafters and open to comments from those groups that will use the law as well as the officials who will implement the law than a process that is dominated by foreign advisers and led only by a small group of government officials. The dominant drafting role that local experts should play cannot be over-emphasised. Local experts know their legal systems, history and culture and are aware of the state of their implementing institutions. Adaptation of transplanted law and international standards takes place through these local experts.

Proof of this can be seen in the few transition countries that developed secured transaction laws by directly transplanting Western models into their legal systems and then struggled to get borrowers and lenders to understand and use the sophisticated collateral registration system needed to make these laws effective. For example, the Romanian Government was quick to adopt a detailed secured transactions law based on US law in order to satisfy World Bank loan requirements. While the law is quite comprehensive, its implementation was significantly delayed in order to make time for the registration system to be finalised. However, it is still unclear how willingly creditors are using the new procedures. Interestingly, over the past two years, a number of the EBRD’s government clients have requested (some have even insisted) that local experts and law firms play a leading role.
An open and transparent legal reform process provides a number of benefits that can increase the ultimate effectiveness of reform, bringing with it the expected improvements in economic growth and development. These benefits arise from the fact that the intended beneficiaries, users and enforcers of new laws and institutions can become involved in their development and implementation.

role in the reform process. The Bank welcomes the fact that governments want their own specialists and experts to take the lead in developing laws and institutions that best suit their legal system and practice.

2) Aids ultimate passage of reform.

Many legal reform projects have gone astray once draft legislation has been passed to a parliament for adoption. However, few legal reform projects have provided assistance directly to the parliaments that ultimately have to pass new legislation and usually have a say in the creation and funding of implementing institutions. For this reason it is important that parliamentarians (and/or their staff) play a direct role in the legal reform process. Key parliamentarians should be consulted when a project is being designed, and they should be involved in the working groups that review and comment on draft legislation. In addition, the coalition of business, financial and regulatory interests that can form to support a new law, regulation or institution can help parliamentarians understand the economic rationale behind the reform during the legislative review and comment period.

The EBRD has only recently begun working with legislatures. In Russia, the Bank worked with Duma members to help adopt amendments to Russia’s company and securities law. During the development of these amendments, the Bank and Russia’s FCSM, with support of the European Commission, held a series of seminars with parliamentarians from key Duma committees where local drafters and foreign consultants explained the proposed amendments and solicited the parliamentarians’ comments on the drafts.

The consultations introduced Duma members to new issues and helped to ease the passage of the amendments. In contrast, the EBRD has run into difficulties in Bosnia and Herzegovina with delays in adopting an EBRD-designed telecommunications policy because of disagreements among the different legislatures and officials in the State and Entity governments and among the different international representatives in Sarajevo. More fully involving these interests in the reform process earlier might have helped avoid this delay.

3) Helps develop consistent laws.

One criticism of legislative reform in developing and transition countries is that laws are often adopted too quickly, with little attention to how they will work with existing legislation. An inclusive reform process that includes a broad group of experts and affected interests will have a better chance of identifying connections between the reform and existing laws and legal institutions and ensuring consistency. Legal reform providers and local reformers should involve specialists who have worked on reforms in other, related legal sectors when setting up working groups and soliciting comments and advice during the development of laws and legal institutions. In the Commonwealth of Independent States (CIS), the EBRD has worked with the Inter-parliamentary Assembly on the Assembly’s legislative harmonisation programme.

In a number of commercial law areas, the Bank and the Assembly have put together teams of legal experts and specialists from CIS countries that have worked on commercial legal reform in their domestic systems to ensure that the harmonised CIS legislation will be as consistent as possible with each country’s existing laws in that area.

4) Reduces opportunities for state capture.

Recent EBRD and World Bank studies have documented the effects of corruption on economic development. In the transition countries “state capture” or the ability of firms to shape the underlying economic rules and institutions by “purchasing” decrees, legislation and influence is a continuing problem. A transparent reform process, one with clear, designated opportunities for multiple, interested groups and businesses to participate in the design and development of commercial laws and implementing institutions, should help to decrease the likelihood that commercial reforms will be “hijacked” for the benefit of one company or a narrow set of interests.

As researchers have noted: “The origins of the capture economy … suggest the need to develop new mechanisms for transparent, competitive, and legitimate channels for voice and influence for enterprises, complemented with de-monopolisation, political competition, greater political accountability to redress the roots of state capture”. Sunshine has been


36 Inconsistency is not just a legislative problem; implementing regulations can also conflict with underlying legislation as one Romanian commentator noted: “If after you issue a very good law, the regulations that follow depart from the law, what is the point?” See M. Dietrich, supra note 30 at p. 17.


Most importantly, legal reform providers should help local governments develop inclusive, open and transparent legal reform processes starting with the design of a reform and continuing with monitoring its implementation.

There is a clear downside to legal reform undertaken through an inclusive and open process that governments and legal reform providers must recognise: reform will take longer and is more likely to result in an incremental evolution of the legal system than a revolutionary change. Building consensus on a reform objective, opening up the drafting and legislative processes to review and comment from a broad range of interested parties and working with potential users, regulators and judges on implementation issues, all take time. An inclusive reform process will not produce quick results, but rather more effective, useful and beneficial results in the longer term. In addition, such a process is likely to produce “the best law that can pass” rather than the “best draft law”. The more interests that are represented in the reform process the more likely it is that the resulting reform will be a product of political and economic compromises. Legal reform providers should not view as failures projects that result in “imperfect” legislation or that attain only 75 per cent of their objectives. If the resulting legislation is one that government sponsors, regulators, judges and market participants understand and will use within the existing legal system, then the reform is a success and one that can be built upon as the economic, political and institutional contexts develop.

For a full description of this legal reform project see K. Mathernova “A reformer’s lessons learned: the case of Slovakia”, infra. p. 48.
Conclusion

In addition to providing help in developing substantive commercial and financial laws and institutions, legal reform providers should leave behind a reform process that can be replicated no matter what the subject matter of the reform may be. This legal reform process should be guided by internationally accepted principles and practices and should include a strong focus on effective implementation. Most importantly, legal reform providers should help local governments develop inclusive, open and transparent legal reform processes starting with the design of a reform and continuing with monitoring its implementation.

These lessons have implications for the future focus of legal reform assistance. First, legal reform providers should help countries develop the administrative procedures and processes that can open up the reform process to a variety of interested groups. Publishing draft legislation and regulations, setting up procedures for formal review and comment, and promoting freedom of information are all necessary to ensure that the reform process is as inclusive as possible. Second, additional assistance should be directed towards parliaments to help improve legislative drafting and to build an understanding of the need for public legislative hearings. Third, assistance should be focused on awareness and capacity building among businesses, NGOs and civil society groups (including bar associations, law schools and the wider legal community) so that they can play a more active and effective role in the reform process. Finally, further thought should be given to creating official or quasi-official legal reform commissions that can lead and guide long-term, sustainable legal transition efforts.41

By helping to build such a process, legal reform providers will improve the legal reforms they are promoting, increase the effectiveness of their assistance and create a coalition of interests ready to support, promote and even demand further legal reform. Through this process donors can gain the support they need among government officials for an inclusive, open and transparent legislative process. 

41 For example, see the work of the New Zealand Law Commission, including an article from a past president of the Commission describing its strengths and weaknesses, www.lawcom.govt.nz. For information on the England and Wales Law Commission, http://www.lawcom.gov.uk/homepage.htm

* David S. Bernstein
Chief Counsel
EBRD
One Exchange Square
London EC2A 2JN
Tel: +44 207 338 6909
Fax: +44 207 338 6150
Email: bernsted@ebrd.com

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What local lawyers think: A retrospective on the EBRD’s Legal Indicator Surveys

Over the past seven years the EBRD has conducted an annual Legal Indicator Survey of lawyers practising in central and eastern Europe and the CIS. The survey is designed to measure and assess lawyers’ perceptions of the evolving commercial and financial legal systems in the region. This article describes the EBRD’s survey methodology and, through an analysis of seven years of data, provides an overview of the trends in legal development and implementation that the Survey has revealed.
In 1995, the EBRD’s Office of the General Counsel developed a Legal Indicator Survey (LIS) in an attempt to gauge the extent to which laws fostering investment in the Bank’s countries of operations approximate international standards and their degree of effectiveness. To date, the LIS has been used to analyse the legal environment in 27 countries of central and eastern Europe and the Commonwealth of Independent States (CIS). The survey provides a useful benchmark to assess the success and pace of commercial legal reform as part of the region’s move towards market-based economies. However, rather than identifying factual indicators, the survey seeks to capture perceptions of laws among those most familiar with how they operate.1

An examination of written law is not, in itself, sufficient in determining the success or pace of legal reform within a country. What happens after a law has been enacted is equally important. Moreover, it is the discrepancy between the so-called “law on the books” and its application and enforcement that is one of the most pressing issues in legal reform today. Understanding the perceptions of lawyers and others who work with the law can contribute to our understanding of how law and legal culture is shaped in transition economies. Some scholars and policymakers believe that how well laws are enacted and implemented directly impacts the rate of foreign investment and external finance.2 This article examines the development of the LIS as an important and innovative analytical tool when assessing commercial legal reform.

Why the Legal Indicator Survey? Taking a snapshot of legal reform

Understanding what the law “is” or how the law has changed is not an easy proposition. In many jurisdictions, keeping up with the pace of legal reform can be difficult. However, an understanding of the substantive law and how the laws work in action are both important elements of a robust and effective legal system designed to attract investment. Furthermore, as the laws change it becomes important to understand their extent and how well they are being implemented at a given moment in time. This helps to trace historical progression and to evaluate the impact of various reforms or amendments within a jurisdiction.

In the early days of transition in the EBRD’s countries of operations, legal reform was evolving extremely quickly, but there was a dearth of published legal materials or reliable legal advice. Not only does the clarity and accessibility of laws impact on how they work, the role of the courts, administrative structures and other institutions have an impact on their effectiveness. How the law worked in practice in the early days of transition is a largely unknown factor, partly because laws and supporting legal institutions were still in a state of rapid development and had not been tested. The availability of information about the status of laws in the EBRD’s countries of operations remains variable, because the law and the legislative process are not always sufficiently transparent and accessible. In some instances, laws are passed without the adequate involvement of affected constituencies; important court decisions are not always published, and independent legal advice may be difficult to find.

In 2002, the status of laws is better known and the Internet has revolutionised the dissemination of legal information. It is much easier, for example, to learn now which laws are applicable in a given jurisdiction. At the same time, data on how the laws work in practice is not readily available. It is difficult, therefore, to assess how effective a given law or legal system is. Similarly, it may not be easy to assess the effectiveness of a specific legal reform project in a short time frame. Yet, such assessments may be necessary in order to identify what further legal reforms are warranted in the near future.2

Recognising this need, the EBRD developed the LIS in an effort to better understand the law and how it works in practice in the transition countries. LIS sought to catalogue the direct experiences of lawyers familiar with investment activities and to assess, from their standpoint, the nature of legal reform.4 It was hoped that by doing so, the EBRD would be able to understand how accurately and efficiently legal information was being disseminated and also how well laws were being enforced.

LIS methodoogy

The first LIS conducted in 1995 focused on laws fostering foreign investment.3 to coincide with the topic of that year’s EBRD Transition report. The purpose of the survey was to give an impression of how conducive the laws in the region were to fostering investment. The survey was repeated in 1996 in an effort to gather additional data for comparison.5

In 1997 the Bank created the Legal Transition Programme (LTP). The 1997 survey mirrored the emphasis of LTP and focused on commercial law reform such as company law, secured transactions and bankruptcy. The survey continued to contain a segment on general legal effectiveness, with many questions carried over from the earlier version. This section focused on how well laws were disseminated and then enforced administratively and judicially. The commercial law survey has been repeated annually since 1997. Sample questions from this survey are discussed throughout this article.

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1 The survey sample covers private law firms, academics and other experts familiar with commercial laws in the transition economies. The majority of private sector lawyers are selected based on their experience in advising the EBRD on local laws in the context of the Bank’s lending and investment activities.


3 In central and eastern Europe, countries have had to engage in significant amendments to their legislation due, in some measure, to the fact that laws may have been enacted too quickly or because of problems with impracticability, ineffectiveness or fiscal resource allocation to fund the project. See Law Drafting and Regulatory Management in Central and Eastern Europe, Support for Improvement and Management in Central and Eastern European Countries. Organisation for Economic Co-operation and Development (OECD) Centre for Co-operation with the Economies in Transition and EU Phare, p. 18. (1997).

4 The EBRD is not the only organisation attempting to assess how well laws are being implemented. The United States Agency for International Development has embarked on a Commercial Legal and Institutional Reform Assessment programme (CLIR) which attempts to assess how well legal reform has been progressed in the following areas: contract law, foreign investment, international trade, company law, bankruptcy law, pledge/collateral law. The World Bank and the International Monetary Fund are also in the process of assessing the implementation of international standards. See World Bank/IMF “Assessing the Implementation of Standard: A Review of Experience and Next Steps” (11 January 2001) located at www.imf.org/external/np/pdr/sac/ 2001/eng/review.pdf.


Table 1: LIS Commercial Law Indicators

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## 1. Extensiveness
Legal rules concerning pledge, bankruptcy and company law are perceived as very limited in scope. Laws appear to impose substantial constraints on the creation, registration and enforcement of security over movable assets, and can impose significant notarisation fees on pledges. Company laws do not ensure adequate corporate governance or protect shareholders’ rights. Bankruptcy laws are perceived as unable to provide for certainty or clarity with respect to the definition of an insolvent debtor, the scope of reorganisation proceedings or the priority of distribution to creditors following liquidation. Laws in these substantive areas have not been amended to approximate those of more developed countries or those laws that have been amended are perceived to contain ambiguities or inconsistencies.

### Effectiveness
Commercial legal rules are usually unclear and sometimes contradictory. The administration and judicial support for the law is perceived as rudimentary. The cost of transactions, such as creating a pledge over a movable asset, is prohibitive so as to render the law ineffective. There appear to be no meaningful procedures in place in order to make commercial laws operational and enforceable. There also appear to be significant disincentives for creditors to seek the commencement of bankruptcy proceedings in respect of insolvent debtors.

## 2. Extensiveness
Legal rules concerning pledge, bankruptcy and company law are limited in scope and are subject to conflicting interpretations. Legislation may have been amended but new laws do not appear to approximate those of more developed countries. Specifically, the registration and enforcement of security over movable assets has not been adequately addressed, leading to uncertainty. Pledge laws may impose significant notarisation fees on pledges. Company laws may not ensure adequate corporate governance or protect shareholders’ rights. Laws appear to contain inconsistencies or ambiguities concerning, among other things, the scope of reorganisation proceedings and/or the priority of secured creditors in bankruptcy.

### Effectiveness
Commercial legal rules are generally unclear and sometimes contradictory. There are few, if any, meaningful procedures in place in order to make commercial laws operational and enforceable.

## 3. Extensiveness
New or amended legislation has recently been enacted (i.e., within the past five years) in at least two of the three commercial legal sectors that were the focus of the survey. However, the legislation could benefit from further refinement and clarification. Legal rules appear to permit a non-possessor pledge over most types of movable assets. However, the mechanisms for registration of security interests are still rudimentary and appear not to provide parties with adequate protection. There is scope for enforcement of pledges without court assistance. Company laws appear to contain limited provisions for corporate governance and the protection of shareholders’ rights. Laws appear to contain inconsistencies or ambiguities concerning, among other things, the scope of reorganisation proceedings and/or the priority of secured creditors in bankruptcy.

### Effectiveness
While commercial legal rules are reasonably clear, administration or judicial support of the law appears to be often inadequate or inconsistent, creating a degree of uncertainty (for example, substantial discretion in the administration of laws and few up-to-date registries for pledges).

## 4. Extensiveness
Comprehensive legislation exists in at least two of the three commercial legal sectors that were the focus of the Survey. Pledge law appears to allow parties to take non-possessor pledges in a wide variety of movable property and contains mechanisms for enforcement of pledges without court assistance. The legal infrastructure, however, is not fully developed to include a centralised or comprehensive mechanism for registering pledges. Company laws contain provisions for corporate governance and the protection of shareholders’ rights. Director and officer duties appear to be clearly defined. Bankruptcy law appears to include detailed provisions for reorganisation and liquidation. Liquidators possess a wide variety of powers to deal with the property and affairs of a bankrupt.

### Effectiveness
Commercial laws are reasonably clear and administrative and judicial support of the law is reasonably adequate. Specialised courts, administrative bodies or independent agencies may exist for the liquidation of insolvent companies, the registration of publicly traded shares or the registration of pledges.

### Overall score:
The overall score is the average of the scores given for the two indicators, rounded up where the average did not fall exactly into the existing categories. A "+" after a number is used to indicate countries that have just made it to the highest tier of one category and are within a few points of reaching the next category in the scale. A "*" indicates countries that are at the bottom of a category where a significant improvement is required for that jurisdiction to fall more comfortably within the middle range for that category.

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**Note:** The classification system described above relates to the Commercial Law indicators. The classification system for Financial Regulations is broadly similar, except that banking and securities regulations and stock exchange functions are used as a reference point. For a description of the Financial Regulations indicators, please refer to the EBRD Transition Report 2001.
In 1998, the survey was expanded to include banking and capital markets. In addition to the general LIS that has been repeated every year since 1998, the EBRD has, from time to time, initiated special surveys on legal sectors of importance to the Bank and its countries of operations. The EBRD conducted a survey on perceptions of telecommunications law reform in 1997 and from 2000 a section was added to the general survey questionnaire on concessions. To develop each of the survey segments, the EBRD has consulted with its own lawyers, who have specific subject matter expertise, as well as with external lawyers and staff at other international financial institutions.

The LIS is a unique instrument in that it tries to identify or at least report the perceptions of how law reform is being implemented. Each year, the EBRD provides a numerical rating for each of the survey countries (based on a rating system of 1 to 4+ for both the extensiveness and effectiveness of its commercial and financial markets laws). In addition, each country also receives an overall score in both the commercial law and the financial markets categories. A description of the classification system, along with survey indicators for each country from 1997 to 2001, are set out in Tables 1 and 2. The indicators are based on raw scores that are, in turn, scaled. As noted in the description of each of the indicators, the ratings are based on perceptions held by survey respondents rather than on an objective assessment of the laws. The EBRD reviews and compares these perceptions with its own experience as a legal “user” in the region (the EBRD being the largest investor in the private sector of the transition countries). At times, the EBRD has relied on in-house knowledge of the conditions in a given country to arbitrate among competing views of survey respondents.

The LIS, like other survey instruments, needs continuous improvement. At times, the sample size gleaned from a particular country has been very small (in some cases less than four respondents). Moreover, the perception of foreign practitioners (e.g., working in a transition economy but trained elsewhere) and of resident lawyers may vary. In the annual publication of country indicators the EBRD notes that care must be taken in reading and interpreting the results. The indicators, however, are useful for eliciting general trends about how the perceptions of practising lawyers may vary from an assessment of law on the books. In addition, the indicators can assist in the individual assessment of each country (in terms of perceptions of each category of commercial law) and in determining how perceptions within one jurisdiction have changed over time.

The survey questions are based on certain key factors that international experts consider to be essential parts of an extensive law in a given area. For example, the ability of creditors to take a non-possessory pledge in movable property is viewed as a significant factor in the creation of a viable market in secured lending. Extensive company law, which includes protections for minority shareholders and capital markets legislation, is viewed as a precondition to robust equity investment in a country.

The EBRD has noted that it tries to capture the perceptions of lawyers with respect to whether laws approximate internationally accepted standards for commercial and financial laws. For example, for financial markets extensiveness is assessed on the basis of whether banking and capital market legal rules approach minimum international standards, such as the Basle Committee on Banking Supervision’s Core Principles or the Objectives and Principles of Securities Regulation developed by the International Organisation of Securities Commissions (IOSCO). The questions on secured transactions originated from the EBRD’s own Core Principles for a Modern Secured Transactions Law. It should be noted that universal principles are not always appropriate for specific countries. Commercial law reflects a diversity of options with respect to legal rules and approaches.

Mindful of these diverse legal approaches, the EBRD has noted that “legal rules that best foster investment do not proceed from first principles. It is possible, however, to evaluate investment laws in the countries of the region against the benchmark of legal rules that are generally accepted internationally as fostering investment. This evaluation reveals whether existing rules are likely to win the approval of the investing community, including foreign investment.” While EBRD commentary on the LIS examines whether countries meet certain legal standards, this is not meant to imply that there is a single optimal legal structure.

Certain questions in the LIS that relate to features or provisions (including those of an aspirational nature) of a specific legal sector that are considered to be most important in creating a favourable investment climate are given greater weight in the final calculation of the ratings. One question in the company law section, for example, asks: “Does your company law provide for cumulative voting by shareholders for the election of directors?” Given the importance of cumulative voting for minority shareholder representation on boards of directors, this question is given greater than average weight. In financial markets, the EBRD also identified key questions that reflect those principles that are most important to a well-functioning financial system. For example, questions concerning the implementation of international accounting standards and insider dealing were identified as more significant than others.
Identifying imprecision

Is the law on the books clear? Another goal of LIS is to assess how well lawyers feel that they understand recently enacted laws and also to learn whether the law as written is applied in practice.

Recognising that there may be a divergence between the law as written and the law as applied or simply an ambiguity in how courts and lawyers interpret a written provision, since 1997 the LIS has attempted to measure this uncertainty by allowing respondents to select from “Yes”, “No” or “Unclear” in response to effectiveness questions. The addition of the “Unclear” response was, in part, due to queries from survey participants who noted that written law and legal practice were often in conflict.

Over the past few years, survey respondents have often included written comments along with their responses to further explain contradiction or lack of clarity with legal rules. For example, the Czech Republic does not have an updated collateral law that would allow for non-possessory pledges in movable property. In practice, lawyers, however, have developed methods for circumventing the restrictions of the law. In Azerbaijan, the Civil Code 2000 required that non-possessory pledges are registered in a government registry but there is no government single registry where parties can register movable property. However, there are registries for only a few categories of movable property such as cars and ships. The law is, therefore, unclear.

Recognising that clarity and predictability are important goals, the EBRD took the decision to deduct a fraction of a point from a survey respondent’s score for “unclear” answers. Further points were deducted from a particular survey if there were multiple unclear responses. Multiple unclear responses are viewed as a potential sign that the law was imprecise and not easily applied by lawyers.

Measuring effectiveness

Since 1995 the EBRD has sought to capture the perceptions of the local lawyers of how effective laws are in each transition country. Measures of the effectiveness of certain commercial and financial laws and the supporting legal institutions, as well as the legal system more generally, have become available to the EBRD, to investors and to many others because they provide an insight into how the laws are perceived to be working in central and eastern Europe and the CIS. The effectiveness measures are also comparable over time and across countries in the region.

The most challenging and therefore interesting task in terms of developing questions and measuring results has been to gather perceptions of how well various laws have been implemented. Effectiveness indicators measure how clear and accessible laws are and the extent to which they are supported administratively and judicially in terms of implementation and enforcement. Perceptions of effectiveness also include some evaluation of legal institutions and government agencies.

Between 1995 and 1997 the LIS questionnaire gave a simple “Yes” or “No” option in answering many of the “effectiveness” questions. In 1997, this was changed to include an “Unclear” response for instances where a respondent was unclear as to whether a certain law or legal rule was being implemented or enforced. In 1999, the responses to the effectiveness questions were amended again and respondents were asked to rate how effectively laws were being implemented on a scale ranging from “never” to “almost always”. These responses correspond to numerical choices ranging from 1 to 5. By expanding the effectiveness responses to five categories, LIS can measure finer degrees of effectiveness. These categories, in turn, help the EBRD to understand whether respondents perceive implementation of a certain law as totally ineffective or whether the law is functioning well nearly all or part of the time.

Is there a role for perceptions-based surveys in the analysis of legal reform?

Perceptions-based surveys are not meant to be an objective report on the status of substantive laws. By way of example, a certain country’s bankruptcy law may or may not contain a provision for restructuring a debtor business. By reading the law, it may be possible to ascertain the answer (typically either a “Yes” or “No”). Sometimes, however, the law itself may be ambiguous or unclear and a plain reading of a statute, regulations or a decree will not provide a clear answer. In this case, an assessment of the law by itself is not a useful means for determining the extent or effectiveness of commercial law.

The LIS is based on two important factors. First, whether a law has been effectively implemented is important in assessing whether legal reform has been successful. Second, that assessing perceptions of legal reform both in terms of whether reforms are extensive and effective is an essential component to measuring the impact of laws in a transition economy.

The LIS measures perceptions in order to understand whether lawyers actually have a clear sense of substantive legal rules and whether such rules are being used and enforced. If no one knows or understands the content of the substantive law, lawyers or investors may not use it as frequently as envisaged. Perceptions of whether a law functions well are as important to their impact on economic transition as whether the written

15. The study of legal rules has had many cases where majority shareholders may also have an impact on levels of external finance as investors need to understand the levels of investor protection in order to decide whether to invest in a given market. LLSV do acknowledge, however, that perceptions may have an effect on the way markets develop, noting that: “It is possible that some broad underlying factor related to trust, influences the development of all institutions in a country, including capital markets.”

Do perceptions matter?
Recent analysis carried out by the EBRD suggests that the effectiveness of legal institutions may have a greater impact on the rate of external finance than the development of law on the books. The EBRD’s Office of the Chief Economist commissioned a study that built on and expanded the research originally conducted by LLSV for each of the years subsequent to transition. The authors of the study, Martin Reiser and Katarina Pistor, also supplemented their analysis of the law “on the books” with an assessment of the effectiveness of legal institutions (which they refer to as “legality”). The results of this EBRD research underscore the importance of measuring whether laws are effectively enforced and implemented and using perceptions to gauge effectiveness.

One of the major conclusions drawn from the EBRD study was that changes in formal rules “may be largely ineffective unless matched by similar rules in enforcement.” Hence the objective measures or assessments of laws “on the books” may not be sufficient to determine how well a legal system is functioning or what impact certain legal rights will have on the levels of external finance. By way of illustration, CIS countries scored very high on the LLSV styled shareholder rights index and also had a “common law” model of company law. However, Russia has had many cases where majority shareholders...
have engaged in large-scale asset striping and minority shareholders and creditors were cheated in various high-profile scandals.

As Pistor and Raiser note, past experience suggests that laws are frequently ignored for various reasons. Prevailing policies or practices may render law reform meaningless. Countries may also lack the resources or capacity to ensure that laws are enforced effectively.25 According to them an assessment of the written laws is not sufficient, by itself, to explain patterns of external finance. They used three variables (referred to as proxies) to measure the effectiveness of legal institutions in transition economies: (i) a rule of law rating provided by a survey of regional experts in the Central European Economic Review; (ii) the LIS index for the overall effectiveness of commercial laws; and (iii) survey data on the ability of the legal system to protect property rights and enforce contracts. Analysing these three proxies, the authors noted striking differences among transition economies:

- A large proportion of firms do not trust the legal system to protect their rights – particularly in the CIS;
- Most countries with lower effectiveness can be found in the CIS; and
- The EBRD’s LIS effectiveness index and the rule of law ratings are relatively highly correlated.

Pistor and Raiser also note that in the CIS the high levels of legal protection achieved in 1998 for shareholder and creditor rights are not mirrored in similarly high ratings for law enforcement. In other words, the law on the books does not correspond to effective implementation of these laws. On the contrary, the pace of legal change may have had a negative impact on the enforcement of laws as legal practitioners, regulators and judges were confronted with new and changing rules. The authors concluded that improvement of the legal framework for the protection of shareholder and creditor rights is not sufficient in itself to attract financial investment. Rather, an assessment of “legality” or legal effectiveness is also crucial. In conclusion, the EBRD study noted that legality has a much higher impact for the level of equity and credit market development than the quality of law on the books.

Similarly, the EBRD concluded in its 1998 Transition report that the lack of effective banking regulations, as opposed to inadequate laws, was the cause of many problems in the financial sectors of various transition countries.26 Thus, if enforcement of legal rules cannot be guaranteed, not only may the credibility of the law be undermined, but also sophisticated new legislation may be counterproductive in the short term.27

Why are perceptions of the law important?28 Subjective assessments of the quality of law and legal institutions may also help to explain certain economic outcomes.29 The EBRD has noted “the best laws and lawyers are not useful if market participants do not trust the courts to uphold their rights fairly and impartially. In many transition economies, the lack of legal credibility has led to the emergence of private enforcement mechanisms, with the arbitrary nature and violence that this can entail.”30

Other studies, including the EBRD-World Bank Business Environment and Enterprise Performance Survey (BEEPS) of entrepreneurs and managers, also used a perceptions-based approach for measuring transition.31 The BEEPS asked entrepreneurs and managers about the extent and nature of their dealings with the state and obstacles to their business. Questions in the BEEPS covered subjects such as corruption, organised crime, state intervention and the influence of firms on governments. The BEEPS further confirmed that perceptions of the legal system are equally important to understanding the role of law within transition economies with respect to business and enterprise performance. The results of the survey revealed that firms across the region did not have a high degree of confidence in the ability of their legal systems to defend their property and contractual rights. As the BEEPS study noted: “confidence in the security of property rights is closely linked with the firms’ overall assessments of governance, suggesting that poor governance weakens property rights.”32

In 1999, the EBRD tested the significance of insolvency laws for the volume of bank credit to the private sector and for flows of foreign direct investment into transition economies. In general, the regressions revealed strong evidence that the country scores for legal effectiveness of bankruptcy rules are significant in determining the ratio of private sector credit to Gross Domestic Product (GDP) in the EBRD’s countries of operations. A similarly strong positive correlation existed between the country scores for insolvency effectiveness and flows of foreign direct investment (FDI). The LIS results seem to confirm the view that legal effectiveness has a stronger impact on FDI inflows than does legal extensiveness. By contrast, the statistical regressions revealed no correlation between the extensiveness of insolvency laws and the ratio of private sector credit to GDP or the flow of FDI.33

Both legal and economic research has thus shown that the effectiveness of legal implementation and enforcement are two determinants of economic development and investment. Perceptions-based surveys, such as the LIS, provide an important tool to measure and assess legal effectiveness.
The following section examines some of the broader trends that emerge from an analysis of the LIS data from 1997-2001 in the commercial law and financial markets areas. This article does not provide an in-depth examination of the sector specific subject areas included in the LIS.\(^35\)

### Extensiveness versus effectiveness

#### Regional comparisons

In 1995, the EBRD concluded that, “despite a great deal of activity, few countries in the region have investment rules that closely approximate international standards.” At the time it was also noted that central and eastern Europe had made greater progress than those of the CIS both in adopting legal rules fostering investment and in applying and enforcing them. The Czech Republic, Hungary and Poland are the most advanced, with the rest of eastern Europe and Estonia also having made considerable progress.\(^36\)

As early as 1995 the Czech Republic, Hungary and Poland were listed as the most advanced with Estonia being cited as having made considerable progress.\(^36\) This trend remained consistent throughout the six years in which the LIS has been conducted. Countries within central Europe and the Baltic states are continually perceived as having more extensive and effective commercial and financial laws compared with other regions. In 1995 only three countries were cited as having made greater progress with enforcement of their laws than with legislation, namely Croatia, Estonia and Slovenia.

In Charts 1 and 2, a regional comparison of countries is presented in the commercial law area for both extensiveness (Chart 1) and effectiveness (Chart 2). Perceptions of the extensiveness and effectiveness of commercial laws remained higher in central European and Baltic states from 1997 through 2001. South-eastern Europe is the region that has the second highest perceived level of extensiveness and effectiveness throughout the period, followed by the CIS countries and Central Asia.\(^37\) It is noteworthy that in the mid 1990s, the south-eastern European region and the CIS both had closer scores with respect to extensiveness – this likely reflects the enactment in the CIS of new legislation in areas such as company law and bankruptcy.

Since 1997 Hungary and Slovenia have been two jurisdictions that have continued to receive consistently high marks for both extensiveness and effectiveness across all the survey categories. These two countries are noteworthy as jurisdictions where perceptions of commercial and financial markets legal reform remain high. For the majority of survey countries, however, there is less consistency in terms of perceptions of legislative reform and implementation. For further comparisons of individual countries, see Tables 1 and 2 on page 16, which show the commercial law and financial markets indicators received for each country annually.

![Chart 1: Perceptions of commercial law extensiveness over time](image)

Even central European countries lauded in 1995 have shown a decline in their indicators over time, reflecting perhaps increased understanding by lawyers of the nuances in their legal regimes. Some countries have experienced declines in their effectiveness indicators despite having a robust legal framework. Declining effectiveness may reflect increasingly negative perceptions held by practitioners in the region as to the ability of government agencies and the courts to grapple with complex commercial and financial markets legislation. Accession countries such as Poland...
and the Czech Republic that have previously received strong scores in commercial law have experienced significant declines in perceived effectiveness of commercial laws, which lowered their overall indicators. In 1999 both countries experienced declines in their commercial effectiveness indicators which rose slightly in 2000 only to decline again in 2001. For Poland this decrease occurred despite revisions to the Commercial Companies Code and amendments to the securities laws to bring them in line with European Union (EU) standards. While these legislative changes were recognised (Poland’s commercial extensiveness indicators were level or improving) the decrease in effectiveness indicators may, therefore, reflect a view that these changes were vague, contradictory or inconsistent. In addition, respondents may be revealing some scepticism as to whether all the legislative changes required by the EU can be effectively implemented. Poland’s very low effectiveness scores for company law reflect this for 2001.38

Another example of the decline experienced by Poland can be viewed as Chart 3, which shows that Poland’s scores for effectiveness of its pledge laws has decreased over time – despite legislative amendments to create a system of nonpossessory pledges in movable property and the creation of a pledge registry.

In contrast to countries with stronger positive perceptions, countries in south-eastern Europe and the CIS, such as Albania, Belarus, Bosnia and Herzegovina and Tajikistan, have received consistently low marks for extensiveness and effectiveness since 1997 (with one notable exception being Albania’s extensiveness score in the pledge law category).39 This may reflect, to a large degree, stagnation in terms of legislative reform and the lack of a robust legal infrastructure, which creates the perception of an ineffective legal system.

37 The following countries are present in each regional grouping:
Central Europe and the Baltic states includes Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Slovak Republic, Slovenia; South-eastern Europe includes Albania, Bosnia and Herzegovina, Bulgaria, Croatia, FR Yugoslavia, FYR Macedonia and Romania; CIS includes Armenia, Azerbaijan, Belarus, Georgia, Moldova, Russian Federation and Ukraine; and Central Asia includes Kazakhstan, the Kyrgyz Republic, Tajikistan, Turkmenistan and Uzbekistan.

38 Poland’s effectiveness score for company law was 34.71 compared with 44.55 in 2000. This decline can be clearly seen in Poland’s effectiveness indicators for its pledge laws which have decreased over time despite legislative amendments meant to create a system of nonpossessory pledges in movable property and the creation of a pledge registry.

39 In 1995, Albania, Azerbaijan, Tajikistan and Turkmenistan were identified as countries where legal rules were furthest from international standards on investment. See “The Contribution of Law to Fostering Investment”, EBRD Transition report 1995, p. 106.
The implementation gap

As early as 1995, the EBRD had identified a persistent gap between the extensiveness and effectiveness of law reform: “In many countries, laws that closely approximate international standards on investment are severely compromised by being unclear, inaccessible or poorly supported administratively or judicially.”

In 2001, the perception that laws are not effectively implemented or enforced remained high in many of the EBRD’s countries of operations. Adequately assessing the gap between the enactment of comprehensive legislation and the implementation of new laws is an area where further study is needed.

As depicted in Chart 4 the commercial law extensiveness indicators for most countries climbed from 1997 through 2000. Whereas in 1997 only six countries received a rating of 4 for their commercial extensiveness, by 2000, nearly a majority of countries in the region (12) have achieved a rating of 4. Interestingly, there was a slight dip in the extensiveness indicators in 2001, with only nine countries receiving a 4 or better. In 2001, respondents appeared to rate substantive laws as being less extensive – through the use of more unclear responses and also through a decidedly more pessimistic view of various laws. This worsening perception may reflect an increased utilisation of commercial laws in some jurisdictions, creating a greater awareness of ambiguities, problems and gaps in substantive legal rules.

In 2000, 20 countries had a higher commercial extensiveness than effectiveness rating. This is representative of the persistent gap between extensiveness and effectiveness indicators that had appeared since 1997 (see Chart 5).

By 2001, however, commercial effectiveness appeared to have caught up with extensiveness ratings – only seven countries had higher extensiveness indicators than effectiveness scores; 11 countries had the same scores for extensiveness and effectiveness; while eight additional countries had higher effectiveness scores than extensiveness. For 19 countries, the implementation gap was perceived as closed and in some cases there was an inverse relationship between extensiveness and effectiveness. The commercial law
implementation gap closed, in part, because effectiveness scores increased and also because extensiveness scores decreased as discussed above.

How can jurisdictions have higher effectiveness than extensiveness scores? One of the possible explanations is that lawyers may believe that, despite legal rules being unclear or ambiguous, in practice, judges and attorneys have developed customs and practices that facilitate an effective functioning of the legal system. Hence, the law on the books may not be clear but legal practice may nonetheless be effective. An example of such a phenomena is Slovenia, which does not have a framework law on concessions but where there is significant concessions activity, especially at the municipal level. Slovenian lawyers and municipalities have developed a relatively effective practice in the absence of a formal framework law. Thus, written law may sometimes be perceived as not comprehensive or ambiguous but nonetheless can be seen to be effective.42

In 2001, Russia was a jurisdiction where its extensiveness scores dropped while its effectiveness scores improved, most significantly in the commercial law area. While Russian respondents indicated that there were problems with the existing legislative framework, perceptions of how Russia has implemented or utilised existing laws appeared to have improved. The World Bank cited Russia’s improvement in July 2001 stating that progress had been made in Russia’s reform of the legal and judicial system, including more transparent procedures for the appointment of judges and a reform of Russia’s civil and criminal codes. Russia’s Arbitration Courts issued a Circular in January 2001 that contained a Survey on the Practice of Arbitration Courts in Dealing with Disputes relating to the Protection of Foreign Investors. This is an example of efforts to provide greater certainty to foreign investors with respect to the Russian court system.

Russia’s perceived increase in effectiveness indicators offers a second explanation for the closed gap between extensiveness and effectiveness in 2001. Legislative changes that impact the overall effectiveness of courts and legislative systems are less frequent and their impact on perceptions of the effectiveness of legal reform are often more subtle. In 2001, many countries enacted legislation or promulgated government decrees aimed at reforming their judicial and administrative practices.43 These systemic reforms may have impacted the perceptions of lawyers throughout the survey countries with respect to the effectiveness of specific legal reforms. Moreover, as noted in Transition report 2000, several countries continued to revamp regulatory structures in the financial services sector with the creation of consolidated regulators. These reforms may also correlate with improved perceptions of the effectiveness of financial regulatory systems in these countries.44

Although commercial effectiveness scores climbed, this does not mean that the EBRD countries of operations are perceived as having wholly satisfactory courts and administrative systems. The LIS includes questions about general legal effectiveness in a country. Questions in this segment related to the effectiveness of the legislative system (i.e., whether laws are made available to the public, and how transparent is the legislative process), and the courts as well as the overall perception of whether the rule of law prevails.

As of 2001, most countries score within a narrow range of between 40 to 60 points (on a scale of 100), while this indicates that general legal effectiveness is not as poor as the implementation of specific laws, a great deal of room for improvement remains. In particular, respondents routinely noted that the salaries of judges remain relatively low and that court proceedings are lengthy and time consuming. Additionally, the ability for parties to comment on draft legislation and regulations remains something that is not routinely made available.

With respect to the effectiveness of the courts and other implementing institutions, some of the areas in need of improvement were identified as early as 1995 and again in 1997, when the LIS shifted from investment laws to commercial laws. In 1995, for example, survey respondents indicated: “courts in most countries appear to lack the resources, training and experience, to handle complex investment disputes adequately.”45 Judicial salaries were specifically identified as a problem in 1995 and continue to remain an area of concern in 2001.

In subsequent years, the LIS revealed various types of deficiencies in the effectiveness of commercial law and legal system. In 1997, it was noted that large notarial fees appeared to impede secured lending in countries that had reformed their civil codes or pledge laws.46 In some jurisdictions, respondents noted that there were significant disincentives to the commencement of reorganisation or bankruptcy proceedings, including high costs extensive involvement of the courts at each step of the proceedings, lack of qualified insolvency practitioners and lack of certainty of the outcome of proceedings. In 1998, respondents noted that procedures for the enforcement of civil judgments needed improvement as well as a shortening of the time involved for court proceedings.47

42 “Frequency and awareness of concessions activity is one factor that may contribute to a belief that an adequate concessions climate exists,” Labadi, Gramshi & Ramaswathy, supra note 7 at p. 26.
43 Annex 2.1 “Legal Transition Indicators”, EBRD Transition report 2001, p. 33. Albania, Kazakhstan and Uzbekistan adopted plans designed to promote and improve the judicial system. Several countries reformed laws that deal with certain sectors or professions that serve as supporting institutions to the court system, including court executors, accountants, notaries and auditors. One notable example is the Czech Execution Decree that went into effect on 1 May 2001 and was designed to address well-known problems with the execution of Czech court judgments by increasing the qualifications of court executors and providing for a quicker and less formal execution procedure.
Effectiveness questions have often revealed interesting trends with respect to the perceptions of lawyers practicing in the EBRD’s countries of operations. The company law segment of the LIS, for example, includes questions relating to corporate governance and the rights afforded minority shareholders. The LIS attempts to discern whether the protections included for minority shareholders in company law, are effective in practice.

One of the survey questions in the general legal effectiveness section asks, “Do practitioners and other parties have an opportunity to comment on draft laws?”. Respondents were able to answer “almost always”, “frequently”, “sometimes”, “rarely” or “never”. For the majority of countries, the responses were mainly, “sometimes”, “rarely” or “never”. Chart 6 shows that in Albania, Bulgaria and Croatia respondents appeared to perceive the legislative process as less open and transparent than in Lithuania, Poland and the Slovak Republic. Surprisingly, the accession countries fall in the middle of the chart. Some respondents in several jurisdictions, including Croatia, Hungary, Poland, Russia and Ukraine indicate that there is no opportunity to comment on draft legislation. These questions help to gauge the perceptions of the openness and transparency of the legal system which, in turn, fosters greater knowledge and understanding of laws that are eventually enacted and implemented.

In contrast to commercial laws, the scaled extensiveness and effectiveness indicators for financial laws remains lower on average. As shown in Charts 7 and 8 the gap between extensiveness and effectiveness of financial markets laws has been persistent from 1998 through 2001. The number of countries that received a 4 for extensiveness increased only

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Chart 6: Negative perceptions of the ability of practitioners to comment on draft laws in selected countries

Source: EBRD Legal Indicator Survey 2001
Note: Respondents were asked: “Do practitioners and other parties have an opportunity to comment on draft laws?”

Chart 7 and 8: Perceptions of financial regulations 1998 and 2001

Source: EBRD Legal Indicator Survey 1998 and 2001
Note: For an explanation of categories, see page 17
slightly from 1998 to 2001. Charts 7 and 8 show that the number of countries that received a 4 rating had increased from only 7.69 per cent to 11.54 per cent. The slower increase in terms of extensiveness relates to the fact that financial markets reform was part of a second phase of legal reform that occurred after other commercial legal reforms had been implemented in many of the EBRD’s countries of operations.

1998 was the first year in which the EBRD included banking and capital markets as part of the LIS. In 1998, the survey results indicated that in both the banking and securities sectors, countries faced serious problems with respect to enforcement and implementation of financial markets laws. Major impediments identified by respondents included a lack of trained regulatory personnel, a failure to conduct supervisory examinations of financial institutions and failure to take prompt and frequent corrective action with respect to troubled financial institutions.49

The gap between extensiveness and effectiveness of financial market indicators was identified again in 1999 and has appeared subsequently in 2000 and 2001 data.49 Many of the countries that had high indicators for financial market extensiveness and effectiveness were the same countries that had received higher scores for commercial law. These jurisdictions included Estonia, Hungary, Poland and Slovenia.50 The effectiveness of capital markets enforcement has lagged behind that of banking. In some part, this is due to the fact that stock exchanges and securities regulators (commissions) were often created more recently. A lack of shareholder depositories and registration systems were another reason why capital markets enforcement was perceived as less robust than banking.51

Perceptions and the use of laws

The LIS sometimes provides counterintuitive glimpses of how lawyers perceive their legal system. In some instances for example, laws or legal systems in central European jurisdictions that would be expected to be perceived as strong and robust may receive lower scores than neighbouring countries in south-eastern Europe, the CIS and Central Asia. What could explain this?

Under-utilisation effect – optimism and pessimism

More frequent utilisation of laws and more robust legal practice may reveal ambiguities, gaps and problems in legislation that are less apparent in those jurisdictions where laws are not routinely used. Thus, in countries with a larger volume of foreign investment and a correspondingly more robust legal practice, lawyers may gain a deeper understanding of the shortcomings in commercial and financial laws through frequent use. Hence, jurisdictions with more frequent legal practice may have scores that decline (for example Poland). Whereas in countries with less economic activity and fewer opportunities to test new commercial and financial legislation, lawyers may view these laws as substantively adequate. These countries can end up with higher extensiveness indicators. This has been referred to as the under-utilisation and may explain higher extensiveness and effectiveness indicators than would be expected for certain countries.

Perceived optimism from respondents in the absence of true implementation is more pronounced in the area of financial markets. In 1999, for example, Albania, Armenia and Moldova received strong scores in both extensiveness and effectiveness of financial markets, despite the lack of a robust banking sector and almost non-existent capital markets. Chart 9 shows the consistently high extensiveness scores that Moldova has received for its capital markets. 51

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50 Ibid p. 49.
51 Ibid p. 48.
legislation, despite the absence of an active securities market, and that Kazakhstan has received for its company law. In 2000, FYR Macedonia had high commercial law effectiveness indicators (in addition to high extensiveness scores). This can be contrasted with Chart 3, where Poland’s scores have declined despite strong law reform in the pledge area. FYR Macedonia, for example, received high marks for the effectiveness of its bankruptcy laws despite the fact that very few proceedings had been commenced under the law enacted in 1998.

One of the most interesting trends identified is that respondents seem to rank countries with comprehensive laws more negatively when these laws have been in place for some time and problems have possibly arisen with respect to enforcement and implementation. In the company law context, for example, scores of countries that have moderate corporate governance protections such as Bulgaria, Poland and Romania have declined recently. This may reflect, to some extent, frustrations experienced by foreign investors who have attempted to enforce their legal rights.52

More broadly, the Czech Republic, Hungary and Poland experienced downturns in their commercial law scores in 1999, which resulted in lower overall scores for each country. Despite small increases in 2000, aggregate commercial law scores dipped again for the Czech Republic and Poland again in 2001. Although these countries have stronger scores as compared with other regions, it appears that over time, practitioners may have increased expectations of what constitutes extensive and effective legal reform and may have become more pessimistic that these expectations are being met.

Similarly, in 1999 the Czech Republic received lower scores for its extensiveness and effectiveness in both the financial markets and commercial law segments despite having comprehensive company and securities legislation – possibly because of conflicts of interest arising from high levels of indirect bank ownership of many companies leading banks to act simultaneously as investors and creditors.53 Romania also experienced a decline in extensiveness scores in 1999.

Perceived optimism arising from laws that are recently enacted

Newly enacted laws may be perceived as comprehensive and extensive when they are initially enacted. This may be due to the fact that lawyers need to have ample time to become aware of any possible defects or gaps in the legislation – such understanding comes with the passage of time. Thus, laws may be perceived more favourably when enacted and then scores may decline – even though the law has not changed.

Generally, countries with recently enacted laws tend to score higher in the year following these legislative changes. Kazakhstan, for example, enacted a new company law in 1997 that replicates many of the provisions of the Delaware Corporations Law.54 The enactment of the legislation led to Kazakhstan receiving a higher score in 1999 compared with significantly lower scores in 1997 and 1998. This pattern can also be seen in other countries.

The Kazakh example reveals another interesting trend that often repeats in the LIS: perceptions of new legislation may not be as high in the year of enactment as in the subsequent year. This may occur because lawyers may not be aware of legislative changes immediately after a law is enacted. New laws may not been widely disseminated or the dissemination may take some time to register in public perceptions. This lack of recognition of new legislation manifests itself in a higher number of unclear responses from lawyers or in answers that are incorrect or contradictory. Moldova’s high score for company law in 1998, for example, may reflect its enactment of new legislation in 1997. In 1999, however, Moldova’s ratings dropped significantly, possibly because problems had been identified with the execution of the law.55

Russia and Uzbekistan also received higher company law scores in 1998, possibly due to new legislation being enacted in 1996. However, their scores dropped significantly in subsequent years. This trend seems to reflect the evolving perceptions of the law once it is implemented. The drop in effectiveness once a law has been enacted and has had time to be tested and utilised is also reflected in the charts relating to Azerbaijan and the Kyrgyz Republic. Legislation that appears comprehensive and robust when it is enacted may be perceived as less effective and also less extensive once implemented.

Strong extensiveness is only one element of legal reform

Extensiveness scores must be read in conjunction with effectiveness scores to come to a more complete understanding of how legal reform is perceived in any jurisdiction. For example, the Kyrgyz Republic is one country that has consistently received strong scores for the extensiveness of its commercial laws. Since 1997, it has undertaken wholesale reform of its pledge, company and bankruptcy law. Nonetheless, it has developed a significant gap between its extensiveness and effectiveness scores – which shows that its relatively comprehensive laws are not perceived as being properly implemented. To review only the Kyrgyz Republic’s extensiveness score, therefore, would be to see only one part of the story with respect to how respondents view the sufficiency of the commercial legal reform.

An example of these phenomena is the perception of the status of bankruptcy laws in the Kyrgyz Republic depicted in Chart 10. The bankruptcy scores steadily improve from 1998 through 2000 – this follows comprehensive reform on the areas of pledge, company law and bankruptcy in 1997. The increase in extensive-ness scores may reflect the increased knowledge and understanding that lawyers gained about the substance of the new law the year after it was enacted. As noted above, this result provides some interesting insight into how legal knowledge is disseminated and suggests that it takes time for practitioners to gain a mastery of the topic. While the Kyrgyz Republic’s extensiveness indicators increased, its effectiveness indicators decreased. In 1998, respondents rated effectiveness as somewhat higher than the extensiveness of the law. However, within three years, the effectiveness score had dropped by 50 per cent.

As of 2000, other countries with large gaps in at least one of the two survey segments (commercial law or financial markets) include Albania, Armenia, Azerbaijan, Bosnia and Herzegovina, FYR Macedonia, Georgia and Ukraine.56 Chart 11 shows the commercial law scores for Azerbaijan between 1997 and 2001. Azerbaijan experienced a series of commercial law reforms in 1997, 1998 and 2000 in the area of pledge and bankruptcy law. The extensiveness scores for Azerbaijan have increased between 1997 and 1999, stabilised in 2000, and experienced a slight increase in 2001. The effectiveness scores also mirrored the extensiveness scores for the first two years. In 1998 the effectiveness scores plummeted and there has been a significant gap of more than 20 points between extensiveness and effectiveness.57

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57 Where there was more than a 20-point gap between extensiveness and effectiveness (on a scale of 100), extensiveness indicators have been discounted for the country. Hence for a country with a 4 for extensiveness and a 1 for effectiveness, which would correspond to a large gap in raw scores between the extensiveness and effectiveness scores, the extensiveness indicator would be decreased. This discounting is based on the assumption that if the gap between legislation and its implementation is too severe, then the law on the books cannot be functioning properly.
Conclusion

The LIS tries to understand how lawyers perceive the development of new legal rules and whether such rules are being implemented effectively. At times, some of the LIS indicators appear contrary to received wisdom concerning the quality of certain laws or assessments of how well a legal system functions when enforcing those laws. This is why the LIS and other perceptions-based research can be illuminating. They provide another dimension to help to assess the pace and success of commercial and financial legal reform in transition economies.

For example, the demand for law reform in many countries may be tied in some respect to how frequently law is used in practice and the perceptions that have developed in relation to various laws. Thus, in countries with relatively few company registrations, bankruptcy proceedings or pledge registrations, there may be fewer calls for change coming from within a country for the reform of a particular law. This might also help international financial institutions and other organisations engaged in finance and investment recognise that a simple reading of the laws in a given country is no substitute for understanding how legal perceptions shape (i) the way in which lawyers advise investors and other clients about the legal climate in a given country, and (ii) the way in which perceptions may shape the demand (or lack thereof) for commercial legal reform and for greater enforcement of substantive legal rules.
Ten years of living legal transition: An EBRD lawyer’s perspective

Investors in transition countries cannot always wait for law reform to address the moving target of legal uncertainty. However, as the EBRD has found, by “using” imperfect laws, investors can learn by trial and experience.
Ten years ago, the first issue of *Law in transition* was published. Although this first issue was modest, its publication underscored the EBRD’s special role as a “transition bank” for central and eastern Europe. The EBRD’s ambition was not only to finance the reform process, but also to monitor, promote, and sometimes critique the economic, legal and political dimensions of this process. For the lawyers employed by the EBRD, the publication of *Law in transition* underscored the unique challenge of working at the Bank. In a region where the legal environments were in a state of significant flux, with landmark legislation being enacted almost on a daily basis, accomplishing the lawyer’s tasks of knowing the law, of assessing legal risks and of facilitating much needed investment in the region by closing deals would be no mean feat.

Ten years on, the legal environments in the countries of central and eastern Europe and the Commonwealth of Independent States (CIS) are still evolving. Moreover, the task of enhancing the rule of law by improving legislation and by building or strengthening the institutions that interpret and administer them remains vital. But the importance of the ongoing law reform effort should not distract from recognising the progress that has been made and the significant changes that have already occurred.

Many laws have been enacted to improve the investment climate in the countries of the region. Perhaps less obviously, the emergence of stronger market economies in the EBRD’s region of investment is not only the product of the law-making process but also of the “law-using” process. As the single largest private investor in the countries of central and eastern Europe and of the CIS, the EBRD and its in-house lawyers have unparalleled experience “using” the laws of the region. From this perspective, two seemingly contradictory conclusions emerge.

On the one hand, 10 years of investing in these new market economies has shown the elimination of legal uncertainty and attendant risk to be a “moving target”. New issues and concerns have arisen hand in hand with the development of market economies. From an investor’s perspective, key laws have almost always fallen short in terms of clarity and scope. On the other hand, as the new market economies posed new problems that had to be addressed and overcome, lessons were learned and the body of legal knowledge increased.

In short, lawyers at the EBRD, advising a committed investor, have learned to cope with the unavoidable imperfections in the legal frameworks. This article looks at some of the shifts in legal focus from one area of legal uncertainty and perceived risk to another during the past 10 years. It is written from the perspective of an EBRD lawyer responsible for facilitating the Bank’s investments. From this perspective, it is apparent that, even as legal uncertainty has remained a constant throughout the period, the concerns have continually changed. Most notably, many early uncertainties have quietly faded in importance.

The economic context: privatisation

The nature of the legal concerns that dominate an investor’s agenda are not merely a function of a lawyer’s analysis. Wider historic phenomena set the stage for innumerable due diligence exercises, legal memoranda and painstaking clause-by-clause negotiations. One of the key historical shifts over the past decade has been the rapid privatisation of enterprises in many of the economies of central and eastern Europe.

Accordingly, in the early 1990s, investors and their legal advisers focused on the risks associated with privatisation, such as environmental risks and other potential hidden liabilities arising from the period of state ownership. Another important set of risks stemmed from the privatisation process itself. For example, if the legally mandated procedure had not been strictly followed could privatisation be challenged or over-turned?

Careful assessment and management of these risks was part and parcel of every decision on whether or not to purchase a stake in a privatised business. To a certain degree, these risks could be managed contractually with representations and the inclusion of warranties and indemnities (e.g., particularly with regard to environmental liabilities). However, in the broader sense, these risks could never fully be avoided by as crude an instrument as a contract. In practice, much would depend on future developments, such as the willingness of the environmental authorities to exercise their discretion reasonably, e.g., when setting deadlines for improvements and negotiating solutions to difficult environmental issues. Moreover, future legislation and developments in the courts would also play an important role.

Understandably, privatisation risks were a concern not only for strategic investors at the time of privatisation but also for financial investors and lenders who provided financing after privatisation. While a financial investor would typically bear less risk than a strategic investor, they typically had less understanding of the specific transactional risks than strategic investors.

At the EBRD, as with other strategic and financial investors, careful consideration was given to identifying privatisation-related risks and structuring deals accordingly. Establishing whether privatisation procedures had been duly followed proved particularly difficult. Due diligence often uncovered procedural oversights and uncertainties, such as the absence of a required resolution or an imperfect transfer of title in assets. Such situations caused particular anxiety as there was no obvious way to “fix” a procedural error. In exceptional cases, written comfort might be sought from the authorities that any technical flaws would not result in the invalidation or unwinding of the privatisation process. However, in most cases, it was not practical to obtain such assurances and the remote risk that a transaction might be unwound was something that the EBRD, like other investors, simply had to bear.

Fortunately, many of the perceived risks in relation to privatisation transactions did not actually materialise. There have been occasional controversies about privatisations netting too little money for national treasuries or legal challenges being brought by unsuccessful tenderers. In several instances involving potential EBRD clients, complaints and litigation surrounding privatisations delayed proposed finance. However, there has not been, as yet, an instance of a privatisation being over-turned. Nor, despite the delays in resolving environmental problems, has there been any significant trend towards holding new owners legally responsible for the mistakes of the past.

Certainly, it is true that investors have made every effort to protect themselves when entering into such transactions by negotiating up-front their liabilities and in some cases third-party recourse. But this can be only part of the story. It is likely that, even where past liabilities were not specifically targeted, it would have been possible for government officials, regulators and judges to make life difficult for new investors where such problems could not always be consigned to the
past. However, the fact that many of the serious difficulties that could have occurred in relation to past liabilities and flawed privatisation plans were avoided is due to the sensible way in which the regulators and courts dealt with issues associated with newly privatised companies.

In short, a serious source of legal uncertainty has faded from view in those areas where the dust has settled on the privatisations of the recent past. However, the privatisation process is still unfolding in some of the countries where the EBRD invests and the same issues and concerns will also apply there. It is hoped that the Bank and the countries undergoing privatisation will learn from this past experience and the investment outcomes will be assessed in an equally positive light.

**The EBRD’s experience of company laws**

For obvious reasons, the private limited liability company is a core institution of the market economy. Yet it is important to acknowledge that the “limited liability company” was a relative innovation in the early 1990s for many of the EBRD’s countries of operations.¹ “Ltd”, in its various linguistic permutations, resonated with connotations of modernity and change.

Given the relative novelty of the corporate form in some countries, as well as the fact that the EBRD only began to invest in 1991,² it is understandable that every legal due diligence exercise included a careful scrutiny of the corporate form of the prospective local client. Particularly in the first investments in any given country, the Bank needed some reassurance that investors’ limited liability was genuinely guaranteed under the law. Sometimes, investigations uncovered potential breaches in the limited liability regulations. Crucially, any such chinks in the company law armour, in contrast with doctrines such as “piercing the corporate veil”, did not benefit from decades of judicial interpretation that exist under common law and could not allay the fears of first-time investors in the region.

In addition to the concerns over the inviolability of limited liability, lawyers looking at investments in the new company forms in the early 1990s faced a wide variety of technical questions regarding how they were established and how they operated. A few examples include:

- Where newly subscribed shares were initially partly paid, when was the remainder of the purchase price due?
- To what extent did a holder of partly paid shares enjoy voting rights in respect of those shares?
- Could the full payment of newly subscribed shares be contractually conditioned on events subsequent to the initial payment? In effect, could a share subscription be unwound?
- With respect to a company in the process of formation, was it necessary or advisable to copy wholesale sections of the company law into the charter?
- How likely was it that particular contractual provisions included in the company charter would result in the registrar’s refusal to register the charter?
- What types of assets were eligible for use as contributions in-kind? What risk was there that such assets would be deemed inadequate with the charter capital being reduced accordingly?
- How feasible was it to use an escrow account to hold subscription amounts given the prospect of non-registration of the company and the legal requirement of payment prior to registration?

Practitioners advising on company law in many of the EBRD’s countries of operations have largely settled these and similar questions. In some cases, legal certainty has been established by such developments as the publication of administrative guidelines and authoritative commentaries or the development of more detailed jurisprudence. However, in other cases, legal practitioners and the authorities responsible for implementing rules and procedures have developed conventions and common views for handling routine matters arising under company laws. In the early days, a local lawyer sometimes provided guidance on a technical matter by producing a reasoned analysis of the relevant company law provision or by referring to an interpretation received from a judge or even a legislative author not uncommonly in the context of a private conversation. Today, by contrast, far fewer topics represent matters of first impression. Advice is rarely given by reference to the interpretations of authoritative individuals. Practitioners are more likely to evoke market practice, simply observing that “this is the way it’s done”.

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1. It should be noted that some EBRD countries of operations were in effect reviving corporate forms that were in use in the not too distant past. However, for other countries, most notably those of the CIS, it was necessary to look to the more distant past for relevant legal models.

2. The EBRD officially came into existence on 15 April 1991. It signed its first private-sector loan agreement on 6 November 1991. The borrower was the Hungarian limited liability company, Petofi Nyomda, and the loan financed the modernisation of a packaging material manufacturing company.
Changes in the legal profession in the EBRD’s countries of operations have played almost as important a part in the Bank’s appreciation of the legal risks as the changes in laws themselves.

Just as some questions relating to company law have been answered others have emerged as new areas of risk or uncertainty. In the early 1990s, the emphasis was on the “nuts and bolts” of investment. Today, the emphasis has shifted to such matters as corporate governance which is, in part, a consequence of the Russian economic crisis of 1998. Abuse of power and poor governance within private companies not only in Russia but also throughout the region were thought to have made these companies more vulnerable to macro-economic shocks. Notably, many banks had ignored prudential banking guidelines and operating procedures and supervisory boards had failed to exercise meaningful oversight. Since the EBRD’s early days of operating in the region, legal and business due diligence in connection with a proposed transaction has included a thorough review of the company’s corporate governance as well as identifying ways in which it could be improved.  

A related matter which was hardly on the “radar screen” when the EBRD first began its work was the area of shareholder protections in relation to company take-overs. In the early days of the new market economy in central and eastern Europe, strategic investors typically arrived on the scene as “greenfield investors” or “acquirers in privatisation”, whether through competitive tender or negotiated sale. However, since then with the development of the capital markets as well as the emergence of stronger, expansion-orientated strategic companies in the region, acquisitions of control over enterprises through capital market activity have become more common.

In the EBRD’s first experience of a hostile take-over involving a company in which the Bank had an equity investment, the laws of one of the region’s most advanced reformers came under scrutiny and were subsequently amended to address perceived inadequacies. As a result of this experience, and given the likelihood that the EBRD’s future investments may also be affected by change-of-control transactions, the EBRD’s decision-makers and lawyers increasingly consider the protections available in various jurisdictions to shareholders who may be confronted by similar situations.

In short, many of the uncertainties which plagued investors when company laws in the region were quite new and untested have now been addressed in large part. New challenges have emerged and, given more sophisticated economies, these may prove more difficult to resolve than the technical questions of the early 1990s. Still, it is noteworthy that the basic features of company law in most of the EBRD’s countries of operations now seem well entrenched and are perceived as providing a satisfactory legal framework for business organisations in those countries.

Enforcing the EBRD’s rights as a creditor

A third area of the EBRD’s legal work that has undergone considerable change since the Bank began publishing Law in transition is secured lending. When the EBRD signed the first secured loan in 1991 none of its countries of operations had workable laws in place to cope with secured lending. Today, the overwhelming majority of the 27 countries have such laws.

The above statistic illustrates the challenge secured lending presented to the EBRD’s lawyers in the early 1990s. In those early days, nearly every new loan involved a probing review of the types of security permitted by the legislation of the relevant jurisdiction, as well as the various obstacles that had to be overcome before security could be created and enforced.

With hindsight, it is again possible to see that many of the lawyers’ worst apprehensions have proved to be somewhat unfounded. The EBRD has now had experience of enforcing security in a number of jurisdictions within its target region. While it may be over-shooting the mark to state that the Bank has been fully satisfied with the results of these enforcement procedures, there have been relatively few instances of fundamental problems emerging with the security. In the first years of the Bank’s work, a central question was whether security could be created over key assets. In the majority of cases, and with the benefit of experience, the Bank has succeeded in achieving this.

In recent years, especially since the economic difficulties that occurred in Russia in late 1998, focus has shifted to the more difficult question of the practical enforceability of creditors’ rights. Here the record is more complex. First, in the context of litigation, adverse parties can, and do, make use of any and all creative arguments available to them. For instance, a typical argument is that the pledging of security is ultra vires because it has not been authorised at the appropriate corporate level of the pledgor.

Second, procedural matters can severely and adversely affect creditors’ rights. For instance, the EBRD was frustrated in its endeavours to obtain a declaration of bankruptcy against a defaulting borrower in Romania. The judge ruled

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2 In part, as a result of the Bank’s experience as an investor, corporate governance is one of the focus areas of the Bank’s Legal Transition Programme (LTP). Projects of the LTP have included help in developing a methodology for a corporate governance rating system for Russian companies, in cooperation with the International Council of Corporate Governance (ICLG). The rating system provides investors with a guide as to which Russian companies apply best practice. In addition, the EBRD has sponsored a project to assist the Russian Federal Commission on the Securities Market (FCSM) to develop a Corporate Governance Code, accompanied by commentary for use as a central reference for companies. The Code is based on the Organisation for Economic Co-operation and Development (OECD) Principles of Corporate Governance, and will provide guidance for improved corporate by-laws and operating procedures.

3 In connection with a take-over of the Hungarian joint stock company, Borsodchem Rt., in 2000, the adequacy of minority protections under Hungary’s 1996 securities legislation was called into question. Act L of 2001 amended the legislation in order to apply the requirement for mandatory public offers to shareholders “acting in concert” who purchased a controlling stake in the take-over target. Significantly, the legislation provided detailed definitions of the terms “acquiring influence” and “indirect influence”. The 2001 amendments to the securities law also mandated more stringent reporting requirements for shareholders acquiring significant stakes in public companies and enhanced the role of the Hungarian securities regulator (the PSzAF) in potential take-over situations.

4 For these purposes, a workable law is deemed to be one providing for non-possessory security over movable assets. See John Simpson, “Ten Years of Secured Transactions Reform”, Law in transition, p. 21, (Autumn 2000).

5 For information on the EBRD’s efforts to improve the legal framework for secured transactions in the region, visit the Bank’s Web site at www.ebrd.com/st.

6 This experience includes both direct enforcement and, in the case of on-lending arrangements with commercial banks, enforcement by those banks of collateral pledged to those banks.
that because the borrower had filed for arbitration challenging the validity of the debt to the EBRD, this was sufficient ground for not granting the declaration of bankruptcy. Third, individual judicial decisions sometimes raise questions about the quality and impartiality of the judges. The Bank has encountered many substantive legal problems. For instance, where local law and practice required the security documentation to include a comprehensive list of the assets to be secured, in certain cases the security list was deemed insufficiently specific and could not in any event capture after-acquired assets. More importantly, in Russia, it has been necessary to incorporate a unique legal feature governing insolvency, namely, the principle that, in a liquidation situation, the secured lender loses its right in rem against specific assets of debtor.

However, just as “nothing focuses the mind like a hangman’s noose”, there is nothing better for improving an institution’s “technique” for creating and perfecting security like dealing with the practical consequences of past failures. Therefore, the Bank and its lawyers have become increasingly comfortable with the process of creating security and with anticipating at least some of the potential pitfalls in the enforcement process.

Perhaps most importantly, many courts appear to recognise the importance of respecting creditors’ rights and therefore no systematic aversion to enforcement actions against local borrowers has been identified.

While there are still improvements to be made, it is important to recognise the central change that has taken place with regard to secured transactions and insolvency laws in the region. The focus has shifted from the feasibility of security and orderly bankruptcy proceedings to concentrate on specific cases and to ensure the quality and integrity of the courts. In many jurisdictions, not only is basic legislation firmly in place but local practitioners and judges are also becoming increasingly familiar with its application. Most importantly, there has been a gradual cultural evolution as creditors’ rights have become generally accepted.

### Working with local lawyers

When considering the changing nature of the work of the EBRD’s in-house lawyers over the past decade, it is important to mention the evolution in external legal advice that the Bank has received during this period. Changes in the legal profession in the EBRD’s countries of operations have played almost as important a part in the Bank’s appreciation of the legal risks as the changes in laws themselves.

When the EBRD first began to invest in the region, there were very few private law firms operating to international standards. Understandably, given the nature of business activity in the region until that time, individual lawyers with significant experience of cross-border investment or banking transactions were in short supply. In those days, when we reviewed the experience of prospective local legal advisers, it often seemed that specialised legal expertise – notably intellectual property – was of little relevance to the project at hand. Most importantly, as basic laws relating to the field of investment and banking were new, local lawyers often seemed vague or uncertain when giving legal advice. While differing opinions on some topics exist among practitioners in all legal systems, they seemed to crop up with unnerving frequency in central and eastern Europe in the early 1990s.

Much has changed in this regard. Today, in the larger markets where the EBRD invests, local legal expertise in cross-border transactions is widely available. First, many international firms have established themselves in the EBRD’s countries of operations and brought excellent local practitioners into their practices. Second, “pure” local firms have developed as full-service providers and built practices with an international clientele.

Ten years of cross-fertilisation has had a significant impact. Compared with the early 1990s, many lawyers from the region have now had the experience of working abroad and the exposure to foreign legal systems. In addition, many more have had the opportunity to work with lawyers practising outside the region, whether as colleagues in their own law firms or as a result of cross-border transactions requiring interaction with foreign lawyers. For lawyers trained in the civil law tradition, contact with lawyers trained predominantly in the common law system is likely to have
In many areas, laws “settle”, precedents are established, abuse is avoided, and judges, administrators and practitioners develop increasingly consistent interpretations and common understandings.

facilitated their integration into the wider community of international practitioners. Most importantly, local lawyers have been the prime “users” of their own national laws and today speak with assurance when advising on a wide range of matters.

What has this meant for lawyers at the EBRD? First, it has meant access and insight into the laws of the Bank’s investment region. With the support of the local legal communities, many of the laws throughout the region can be accessed on CD-ROM and the Internet. In addition, both locally-based and international law firms now provide periodical updates on legal developments in the various countries. In the course of their work, such firms have also provided the Bank with a wealth of legal memoranda and other written advice. All of these elements have helped build the EBRD’s knowledge of the legal environments within which it operates. The legal professions within these countries have developed beyond merely facilitating the acquisition of information. They are now full partners such that the Bank’s in-house lawyers are no longer “whistling in the dark”. Instead they are able to work in creative collaboration with local practitioners who are able to raise genuine concerns while proposing workable solutions.

Conclusion

Ten years after the publication of the first edition of *Law in transition*, law reformers are still usefully employed throughout central and eastern Europe and the CIS. The past decade has demonstrated that, where the legal framework for investment activity is concerned, there is always room for improvement. Changing times raise new concerns. Laws come under scrutiny as and when developments in the marketplace shift the focus of investors’ concerns. Inevitably, such scrutiny reveals gaps and uncertainties in the laws and their application. The “imperfections” so identified are the grist for the mill of law reform activity.

Nevertheless, ten years of investment activity in central and eastern Europe and the CIS reveal that not all “imperfect” laws need to be fixed. In many areas, laws “settle”, precedents are established, abuse is avoided, and judges, administrators and practitioners develop increasingly consistent interpretations and common understandings. Legal systems develop not only as a result of deliberate reform but also through daily use. For the EBRD’s in-house lawyers, ten years of investing in the region have provided an invaluable experience regarding a variety of legal risks in the rapidly evolving economies of the region. In this way, the “comfort zone” has gradually increased and legal confidence has grown apace with economic improvement.
The EBRD’s legal reform work: Contributing to transition

During the past decade the EBRD’s Legal Transition Programme has been involved in legal reform efforts throughout the region in several areas of commercial and financial law. This article looks at the state of legal reform, gives examples of the Bank’s work that have contributed to the legal transition process, and looks ahead at the key challenges that the transition countries face in their endeavours to reform and develop their economies.
Despite countries taking different routes when first embarking on developing capital markets, capital markets laws in a number of transition countries are gradually approximating those of jurisdictions with mature capital markets and, more recently, relevant international standards.

The state of legal reform in the countries of central and eastern Europe since the fall of communism has been the subject of discussion and debate in many articles. The countries of the region have undertaken to radically revise their legislation to allow for the development of modern market economies. These undertakings have often resulted in successes, some in failures, and have provided a number of lessons that can serve the countries in the future. The EBRD, as a principal investor in these countries and as a multilateral development bank with a mandate to assist the central and east European countries to develop market economies, has often taken the lead in providing technical assistance for the development of commercial laws and legal institutions. Through its legal reform projects and legal sector assessments, the EBRD has been able to share its expertise and experience with local drafters and legislators.

This article provides an overview of the present state of commercial and financial law in the region, based on the personal experiences of EBRD lawyers working on legal reform activities, and looks at the trends that will potentially shape legal reform in the next few years. The article is composed of sections that reflect the legal sectors in which the EBRD has been primarily involved, namely, capital markets and corporate governance, concessions, bankruptcy, secured transactions and telecommunications. Each of the sections describes a few examples of the work that the EBRD has carried out in the region, as well as the general state of legal reform in the specific area. In addition, the sections elaborate on the main challenges that the EBRD believes these countries will face in their ongoing endeavours to reform the laws and implementing institutions that support market economies. Both positive and negative past experiences can assist law reformers as well as international institutions aiming to contribute to the region’s efforts to move legal transition forward.

**Capital markets and corporate governance**

A developed capital market is meant to provide transition economies with several benefits for market participants. For companies, the capital market is an important venue for raising capital, an alternative to banking institutions and other private or internal sources. Indirectly, a sound capital market can increase the efficiency of corporate performance and discipline management by enhancing good governance. For the state, a capital market can serve as a useful instrument to help implement privatisation programmes, mobilise national savings and attract foreign investments. To most of the countries in the region, privatisation has been the main driving force behind the establishment of capital markets. For individuals, the capital market provides a forum in which they may invest their savings, thereby indirectly benefiting from the potential company growth.

Over the past decade most of the countries in the region have had to establish their capital markets virtually from scratch. In doing so, countries have pursued different approaches and taken account of various policy considerations when designing and implementing their respective economic reform programmes. In some countries (e.g., the Czech Republic), capital markets were initially created as support institutions necessary to implement massive voucher privatisation programmes. In such cases, capital markets were established even before sound regulatory frameworks and competent market regulators were put in place.

For some other countries (e.g., Poland), the more traditional approach was followed: the necessary legal institutions were created before trading practices were established in the market. Other countries in the region continue to have underdeveloped capital markets due to a lack of favourable economic conditions.

In those transition countries that have established capital market-related legal institutions over the last decade, a common phenomenon can be observed. Despite countries taking different routes when first embarking on developing capital markets, capital markets laws in a number of transition countries are gradually approximating those of jurisdictions with mature capital markets and, more recently, relevant international standards. This phenomenon can be attributed to two factors.

One factor is aspiration for European Union (EU) membership. For the ten EU accession countries where the EBRD operates, the adoption of the *acquis communautaire* (including as it concerns capital markets) is a prerequisite for becoming an EU member state. Through bilateral twinning programmes with existing EU member states and EU technical assistance projects under the Phare programme, the capital market-related legal institutions and regulatory framework of EU accession countries have been extensively refined to bring them into line with the relevant EU directives.

Another factor that contributes to the approximation phenomenon is that international financial institutions (IFIs) and various bilateral donor agencies have begun to promote best market practice in capital markets and, in recent years, have begun to develop international standards. The International Monetary Fund (IMF), the World Bank and the EBRD are promoting international best practices and, in recent years, regional standards in the transition countries via surveys, technical assistance and assessment programmes.

In the capital market area, the relevant international standards generally promoted by IFIs include:

- the Objectives and Principles of Securities Regulations published by the International Organization of Securities Commissions (IOSCO);
- the International Accounting Standards promulgated by the International Accounting Standards Board; and
- the International Standards on Auditing issued by the International Federation of Accountants. In the corporate governance area, the applicable international standards are the Principles of Corporate Governance published by the Organisation for Economic Co-operation and Development (OECD) in 1999.
The EBRD and capital markets legal reform

While the EBRD’s Legal Transition Team was created in 1995, the EBRD was not directly involved in providing legal technical assistance in the capital market area until 1998, when it undertook a project to assist the Czech Republic in establishing a capital market regulator, the Czech Securities Commission (the Czech SEC). The project provided assistance to the Czech Government for amending the capital market legislation, structuring the organisational and regulatory functions of the Czech SEC and training the Czech SEC staff. Subsequently the EBRD undertook a project in 2001 to assist the Hungarian Ministry of Finance in drafting a new Securities and Investment Services Act. This project was designed to assist Hungary in bringing its main capital market legislation into line with international standards and the relevant EU directives.1

During the past few years the EBRD has been helping the Russian authorities improve their capital market and corporate governance related legislation. The Bank has worked with Russia’s Federal Commission for the Securities Market (FCSM) on a project to refine Russia’s company and securities market legislation (amendments that took effect earlier this year). It is presently working with the FCSM to improve Russia’s legal and regulatory framework governing the debt capital markets. This latter project is designed to establish in Russia a clear regulatory regime, under which the supranational organisations and foreign corporations may be able to issue rouble-denominated debt securities to raise rouble funds in a cost-efficient way. The EBRD has also provided Russia with corporate governance assistance. Russian companies in the past have been sharply criticised for notorious violations of property rights and minority shareholders’ interests. To address these issues, the FCSM, with EBRD assistance, has recently developed a Corporate Governance Code, officially unveiled in April 2002. The EBRD has also assisted a Russian non-governmental organisation in developing a corporate governance rating system.

In addition, the EBRD is undertaking a Corporate Governance Regional Assessment Project using a corporate governance checklist developed by EBRD lawyers and based on the OECD Principles of Corporate Governance to gauge the status of corporate governance related laws and regulations in the 27 transition countries. This exercise represents the Bank’s efforts to better understand legal developments in the region and can serve as a reference for the countries formulating future reform.

Future reform challenges

After more than ten years of transition, the development of capital markets and the degree of sophistication of the legal and regulatory frameworks in the EBRD’s region of operations varies from country to country. However, while the countries are endeavouring to establish modern and efficient capital markets, the world financial markets are not standing still and the global economic environment is rapidly changing, especially in recent years. For example, since EU capital markets are evolving rapidly due to technological advancement and the introduction of the Euro, by the time the accession candidate countries satisfy current EU membership conditions, the landscape in the western European capital markets may have altered substantially. Meanwhile, the strong globalisation and consolidation trends in the world financial markets in recent years raise concerns about whether transition country capital markets will ever achieve the necessary economies of scale to compete internationally.2 These considerations have made some of the countries in the region consider the difficult policy decision of whether it is still worthwhile for them to invest the time and resources necessary to establish individual capital markets.

Despite these uncertainties, if a transition country decided to develop a national capital market the clear message from the present transition country experience in developing capital markets is the following: the adoption of legal and regulatory frameworks similar to those in developed countries and necessary for the establishment and operation of capital markets is not a difficult task, but the key to developing and maintaining sound capital markets in the long term lies in strong supervision of market activities and rigorous enforcement of legislation. Certainly, supervision and enforcement will require sufficient supply of qualified and sophisticated capital market professionals in the public sector (e.g., market regulators, judges). This is an area where IFIs and bilateral donors can and should play an important role as financial and technical assistance providers.

2. The EU, Germany, the UK and the US are active donors in facilitating capital market reforms in the region. For example, USAID has provided technical assistance in drafting capital market legislation for several countries in the region, including Armenia, Kazakhstan, the Kyrgyz Republic, Latvia, Moldova, Russia, Ukraine and Uzbekistan (see Katharina Pistor, “Patterns of Legal Change: Shareholder and Creditor Rights in Transition,” Working Paper No. 49, EBRD, London (May 2000)). It is therefore, understandable that capital market legislation in those countries, to a certain extent, has strong resemblance to relevant US laws.

3. For example, since May 1999, the IMF and the World Bank have been jointly running the Financial Sector Assessment Program (FSAP). The FSAP is designed to help alert national authorities of the participating countries to potential vulnerabilities within their financial sectors. FSAP also serves as a foundation for financial sector technical assistance programmes. The IMF and the World Bank are also undertaking summary assessments of participating countries’ observance of key financial standards. As of the end of June 2002, less than ten countries from the region, the majority of them being EU accession countries, have participated in these two exercises.


Concessions law reform

The countries of central and eastern Europe and the CIS have in the past decade faced the necessity of finding alternative sources to public funds for financing public infrastructure and services. Sharing financing responsibilities between public and private sectors is a fairly new concept for countries where private companies have not historically played a great role in the economy. One way that governments in developed market economies attract private sector money is by granting concessions. Concession-related arrangements involve a number of areas of law, such as contract, administrative, tax, property and pledge law. To address various issues in a manner beneficial to the public interests and in a way that will attract private sector funding, public authorities in transition countries have begun to seek assistance from IFIs, bilateral assistance providers and individual governments with well established public-private partnership experience. The EBRD has helped to encourage and facilitate this exchange of experience and has provided assistance with building concession frameworks.

State of concessions reform and standard setting

Transition countries started developing their laws on concessions in the early 1990s. These laws were designed to support the transition to a market economy as well as attract private financing. As a result, early concession laws set out general rules and procedures without going into details. The transition countries took as reference points standards commonly accepted in other more developed jurisdictions. It was not until the late 1990s that internationally accepted principles and standards were developed and widely supported by multilateral institutions and UN bodies – the United Nations Industrial Development Organization (UNIDO), United Nations Economic Commission for Europe (UN ECE) and the United Nations Commission on International Trade Law (UNCITRAL). Among these international efforts, UNCITRAL’s Legislative Guide on Privately Financed Infrastructure Projects (the PFI Legislative Guide) has been used most extensively. The PFI Legislative Guide is the product of several years of work by experts from countries and institutions all over the world, including the EBRD. It contains recommendations deemed necessary for establishing a comprehensive legal framework on concessions. Following the adoption of the PFI Legislative Guide in 2000, UNCITRAL established a working group entrusted to produce model legislative provisions in the area of privately financed infrastructure projects (PFI). The EBRD has been an active member of this working group.

In addition, the UN ECE launched a Public Private Partnership (PPP) Alliance in March 2002. The PPP Alliance’s primary objective is to bring together public authorities, private businesses and relevant international institutions to help transition authorities attract expertise and, possibly, investment finance through concessions.

As the largest single investor in the majority of its countries of operations, the EBRD is well positioned to evaluate and assess the legal framework for concession financing in the transition countries. Through its annual Legal Indicator Survey and a newly developed concessions assessment tool, the EBRD has begun to assess concession laws in the region against internationally accepted standards and principles such as the PFI Legislative Guide. These assessments allow the EBRD to evaluate the status of concession reform in the transition countries and to assist those countries that require aid in creating or improving their laws and regulations.

The most recent Legal Indicator Survey suggests an overall improvement in the region as far as extensiveness of laws. Countries such as Armenia, Belarus, the Slovak Republic and Turkmenistan improved their legal systems dramatically. The laws as perceived by local lawyers changed from a system that was not conducive to investment into one that is somewhat closer to international rules. However, only half of the countries surveyed have enacted consolidated framework legislation and even when these laws are present, the Survey results indicate that they are not being effectively implemented or enforced. This could be due to the newness of the laws and the inexperience of officials that must negotiate concession agreements. Overall, Survey indicators for concession laws are lower than in other categories, such as secured transactions or insolvency law.

There may be a number of reasons why the concession laws in some countries that seem to have addressed basic concession principles still do not attract private investors. Lithuania, for instance, has had a concession framework law for six years but no concessions have been granted. This may be due to the lack of flexibility in the Lithuanian law, which gives an investor only an option of a build-operate-transfer arrangement where all assets are to be transferred back to the government/municipality at the end of the concession. This arrangement may not necessarily be the best option for all investors or for all sectors and industries or even for the government/municipalities themselves. As a result, the EBRD is working with the Lithuanian Government to amend the law to allow concession arrangements to be negotiated on a case-by-case basis.

EBRD and concession reform

The EBRD has been active in trying to help a number of transition countries refine or develop a legal regime to support concession-based financing and to attract private sector financing. The EBRD has provided legal technical assistance in the concessions law area to FYR Macedonia, Lithuania, Romania and Slovenia. In Romania the EBRD provided advice to the National Agency for Privatisation, which was preparing a concessions law and helped to draft regulations based on the relevant EU directives on utilities and public services. In FYR Macedonia the EBRD helped with the implementation of a sector-specific concessions law (the Energy Law) by developing a model concessions agreement. Most recently, at the request of Serbian authorities, the EBRD has reviewed a draft version of the Serbian Law on Concessions and made numerous suggestions designed to make the draft Law more investor friendly by reducing ambiguity in its language and increasing its effectiveness.

EBRD concession reform assistance has focused on creating a sound legal basis for concession-based financing using internationally accepted principles and standards. The Bank has also provided implementation assistance by helping prepare regulations and model concession agreements as well as by providing training to government officials.

Trends and future concessions reform needs

Since the adoption of the UNCITRAL PFI Legislative Guide, the EBRD has applied the Guide’s recommendations in its legal technical assistance projects in various countries of central and eastern Europe. Technical assistance provided recently by other organisations has also largely taken into account UNCITRAL and UNIDO guidelines in this area. The application of internationally recognised recommendations provides a more unified and consistent approach to the regulation of concession arrangements based on modern international experience.

The laws of the early 1990s have largely fulfilled their task of creating general rules and procedures for the early transition period. However, as concession-based financing has become more demanding and sophisticated, the nature of concession legislation must address more complex issues and become more flexible. As a result, it is likely that further reform of concession laws in the transition countries will be influenced even more by internationally accepted standards, guidelines and model legislative provisions.
Insolvency and bankruptcy

State of insolvency reform in the transition countries

Although many commentators focus on ten years of transition when measuring the success or failure of legal reform, starting from 1989, this may not be the proper benchmark when assessing insolvency reform in central and eastern Europe and the CIS. Rather, many of the major reform efforts have occurred since 1995, and the development of an effective insolvency culture and legal practice is still taking shape.

An early study of insolvency reform, undertaken in 1995, can provide a baseline for assessing the state of insolvency laws and institutions in the transition countries. This initial study concluded that:

■ there was no active creditor class in the region that could be relied on to commence insolvency proceedings;
■ there was a lack of proper infrastructure for the implementation of insolvency laws, limiting enforcement of these laws; and
■ attention should be focused on developing the role of the judiciary and of the insolvency professions (lawyers and court appointed liquidators) as well as the creation of detailed procedural rules to be used in insolvency proceedings. Thus, a gap between extensive laws and effective implementation was apparent in 1995.

When the EBRD began assessing insolvency reform in its Legal Indicator Survey (LIS) in 1997, the Bank noted that efforts had already been made to refine legal frameworks that had been put in place during the early 1990s. The EBRD noted that many countries (more than one-third of those surveyed) had recently adopted new insolvency legislation or amended laws enacted in the early 1990s. Subsequently, in 1998, the EBRD noted that FYR Macedonia, Kazakhstan and Russia had enacted new insolvency legislation. This legislation was part of a “second wave” of legislation designed to fix or correct problems that arose with the earlier laws enacted at the beginning of the transition period.

At the time of the 2001 Survey, more than half of the transition countries had enacted new insolvency legislation or substantially amended existing laws within the past two years. As of 2001, insolvency has been the most active area of commercial law reform surveyed by the EBRD (as compared with pledge and company law). This may be in part a response to the growing number of insolvent enterprises in many countries and to the need for legal procedures for their liquidation. Additionally, EU accession has prompted central European countries to revisit legislation enacted during the early 1990s. Many of the jurisdictions perceived as having barely adequate insolvency systems are perceived now as having developed legal frameworks that provide for reorganisation procedures. This trend has continued with additional legislative reforms occurring in 2000 and 2001.

The EBRD’s findings point out that the majority of countries have adopted fairly comprehensive insolvency legislation but a gap remains between the extensiveness of this legislation and its effective implementation. In a few instances, small shifts either upward or downward were probably due to changes in the perceptions of the effectiveness of insolvency regimes.

Bankruptcy indicators remain the lowest in terms of both extensiveness and effectiveness in the commercial law section of the LIS (which includes pledge and company law). The effectiveness scores in particular remain low, indicating a perception that insolvency proceedings continue to take too long and are not effective. Unfortunately, large-scale insolvency reform, which took place in 2000, has not led to a perceived improvement in the effectiveness of bankruptcy practice in the EBRD’s countries of operations. Two notable exceptions in this field are FYR Macedonia and the Slovak Republic, where effectiveness indicators have increased significantly.

As countries continue to amend their legislation, it appears that there are common problems or concerns that many jurisdictions share. For example, when and how insolvency proceedings should be commenced is an area where many jurisdictions have amended their laws in an effort to provide clearer procedures and definitions. Similarly, the power of a bankruptcy liquidator or trustee is something that is being further delineated. Liquidators represent a new professional group in many jurisdictions and countries are attempting to define their role within the court system in greater depth.

EBRD role in bankruptcy reform and standard setting

At the time that the EBRD developed the LIS there were no international guidelines or best practices for the development and implementation of insolvency legislation. Since that time, the World Bank, with active EBRD involvement, has created such guidelines and many of the principles embodied in the World Bank’s guidelines are reflected in the Survey’s insolvency questions. In addition to the World Bank’s guidelines, UNCITRAL is well under way with a project of preparing:

■ a comprehensive statement of key insolvency law objectives;
■ a legislative guide on insolvency law dealing with core provisions of an effective and efficient insolvency regime; and

Concessions was added to the Survey in 2000. See, Labadi, Gramshi & Ramastrasy, “A Favourable Concessions Regime: A lender’s Perspective and Perceptions from Transition Countries”, Law in transition, pp. 20-28 (Spring 2001).

9. Richard D. Coates and Arlene Mirsky, “Restructuring and bankruptcy in central and eastern Europe,” Deloitte Touche Tomatsu International Report (1999). The countries surveyed were Albania, Bulgaria, the Czech Republic, Estonia, FYR Macedonia, Latvia, Lithuania, Poland, Romania, the Slovak Republic and Slovenia.

10. In 1996 commentators continued to note that the use of bankruptcy procedures was still relatively infrequent in central and eastern Europe and the CIS. See, generally, Michael Kim, “When non-use is useful, bankruptcy law in postcommunist central Europe”, Fordham Law Review, Vol. 60 at p. 1043 (December 1996).


12. One commentator familiar with the region noted that insolvency reform has occurred at a faster pace in the EBRD’s countries of operations than commercial law reform efforts elsewhere. The Hon. Samuel Bufford, “Bankruptcy law in European countries emerging from communism, the special legal and economic challenges”, American Bankruptcy Law Journal, Vol. 70, p. 459 (Autumn 1996).


alternative approaches to out-of-court insolvency processes.\textsuperscript{16}

The EBRD, the World Bank, other IFIs and international insolvency experts and practitioners are all working with UNCITRAL on this effort.

The EBRD has supported a number of transition countries in their efforts to revise their insolvency laws and implementing institutions. Early in the transition effort, the EBRD assisted Azerbaijan and the Kyrgyz Republic with their bankruptcy laws. The EBRD also assisted Russia in developing implementing regulations for one of its early bankruptcy law revisions in the mid-1990s. More recently, the EBRD has begun working with Polish authorities on the adoption and implementation of a major re-write of their insolvency legislation. This assistance will include training efforts for Polish lawyers and judges.

A recent trend has been for countries to enact special legislation to address the issue of insolvent banks. Russia, for example, enacted a new law in 1999 to deal with insolvent financial institutions, partly as a reaction to the bank failures that occurred in 1998.\textsuperscript{17} The EBRD and World Bank held a regional seminar earlier this year in an effort to identify commonly used principles and practices for bank insolvencies. In addition, the EBRD is developing a regional CIS project that will prepare model bank insolvency legislation.

In addition to these reform efforts, the EBRD is presently undertaking a detailed assessment effort to better understand existing insolvency laws in the region. Using a checklist formulated by the EBRD and incorporating the international insolvency issues identified in reports by the World Bank, the IMF, the Asian Development Bank and UNCITRAL, the Bank is developing a detailed assessment of the state of insolvency laws for each of the EBRD’s 27 countries of operations.

Trends and future reform needs

From the EBRD’s surveys, assessments and legal reform assistance efforts, a number of general trends in insolvency systems can be observed. The following trends point to the need for further, specific insolvency reform efforts:

Practitioners commonly remain unaware of priorities during liquidation.

While nearly all jurisdictions now recognise the right of secured creditors to have first priority for payment of their debts during liquidation or to have the property securing their debt removed from the debtor’s estate,\textsuperscript{18} practitioners are often uncertain about whether secured creditors took first priority and what the other priority rankings were. In some instances, this is because the civil code provisions on secured lending may conflict with insolvency laws. For example, the Albanian “Law on Bankruptcy” is unclear on the issue of priorities among creditors, while the Albanian Civil Code fails to give secured creditors a priority position. In other circumstances, ambiguities exist in the insolvency law itself. Romania’s insolvency legislation, for example, had stated that debts of shareholders are last in priority whereas secured creditors receive highest priority, leaving an uncertain status for shareholders who had made secured loans to a company. Amendments have now been made to the law to protect the rights of shareholders who are also secured lenders.

Lack of clarity in insolvency legislation concerning the role of the liquidator.

For most countries, practitioners are often uncertain as to the extent of a bankruptcy liquidator’s authority and powers. This is based in part on the fact that more or less specific provisions concerning the liquidator are contained in a number of laws. Moreover, some of a liquidator’s powers develop through custom and practice and cannot be discerned from a simple reading of an insolvency law. Recent legislative changes, however, have attempted to address this problem by specifying more clearly and enumerating a liquidator’s or trustee’s powers. FYR Macedonia amended its insolvency law in July 2000 to include a further enumeration of powers for the insolvency trustee and the courts.

Implementation problems.

If procedures to trigger a bankruptcy proceeding are unclear, debtors and creditors alike are uncertain as to whether to commence insolvency proceedings. Unfortunately, amendments designed to speed up the insolvency process can themselves create confusion. This was the case with the amendments to the Czech Republic bankruptcy legislation proposed by the Government in April 1998. Similarly, Georgia has been cited for poorly defined trigger conditions. The Georgian law was modified in 1997 so that unpaid obligations or a "balance sheet test" rather than liabilities exceeding assets could trigger bankruptcy. However, the use of this balance sheet test can sometimes be difficult to implement against an insolvent company due to uncertainties in accounting methodology in transition companies.

Secured transactions

Ten years of reform and standard-setting

The past ten years have seen active reform in the field of secured transactions across the world. The legal regime for using moveable assets to efficiently secure obligations is now generally acknowledged as an essential element of any market economy. The purpose of secured transactions has always been to mitigate the risk
of giving credit and therefore enhance creditors’ confidence that they can recover real value from pledged assets. As a result, provided that the credit sector is sufficiently developed and competitive, secured transaction reform can increase the availability of credit and improve the terms (typically, the amount of the loan, the period for which it is granted and the interest rate) on which credit is available.

The EBRD has played a pioneer role in identifying and establishing general standards and principles for secured transactions by publishing in 1994 a Model Law and providing technical assistance to a number of transition countries. The Bank felt that developing a model law incorporating some of the financial solutions developed by common law countries while respecting the civil law heritage shared by the countries would be of great assistance. Since 1994, several international organisations have produced a number of international secured transactions standards or general principles.

The legal system developed in the 1950s in the United States (Article 9 of the Uniform Commercial Code) and revised recently has also had considerable influence across the world, particularly in Australia, Canada and New Zealand. The EBRD is particularly well placed to assist in legal reform on secured transactions: as an international financial institution, its mission is to promote and foster transition to market economies; as a commercial bank lending primarily to the private sector, its activities must be based on sound banking principles. It has, therefore, first-hand experience of the impediments that insufficient legal regimes can bring, and it can mobilise legal technical assistance to help countries overcome these impediments. Over the years, the EBRD has developed extensive expertise in this domain.

Although the core principles of a sound secured transactions regime seem simple enough and not particularly controversial, the task of reflecting them in legal provisions and institutions and ensuring their smooth and efficient operation is a mighty one. It is encouraging, therefore, to see that all of the EBRD’s countries of operations have, to a greater or lesser extent, tackled the subject and worked, or are working, on devising the appropriate pledge law legal provisions.

Rather surprisingly for some, Russia was the first country in the region to adopt (in 1992) a new law providing for a non-possessory pledge over movable assets. This law has had an important influence on other CIS countries. Unfortunately, due to inadequate implementation, the law never developed to its full potential. Like Russia, many other CIS countries have reformed their Civil Codes, which almost invariably contain some provisions on secured transactions. Naturally, over the years, secured transactions regimes among these countries have drifted apart: for example, Kazakhstan, the Kyrgyz Republic, Moldova and Ukraine have developed somewhat different and more advanced regimes than their neighbours.

In central Europe, Hungary and Poland adopted new regimes in 1996; surprisingly the Czech and Slovak Republics were much slower in putting this issue on the legislative agenda and started reform only in 2000. In the Baltics, Latvia and Lithuania, and to a lesser extent Estonia, have put in place secured transactions regimes. In south-eastern Europe, Albania, Bulgaria and Romania adopted new provisions from 1996 to 1999, which in the case of the two latter countries, took some time to be implemented (not until early 2001). In the states of the former Yugoslavia, reform has been more patchy: only FYR Macedonia is currently equipped with an extensive system for non-possessory charges; Croatia and Slovenia have both adopted limited provisions that can be used for non-possessory charges; Bosnia and Herzegovina has recently adopted new laws that await implementation, while FR Yugoslavia (Montenegro and Serbia, including Kosovo) have only recently begun secured transactions reform. However, despite reform having taken place across the region, the reform processes used and the results vary considerably.

**EBRD approach to secured transactions reform**

From the EBRD perspective, having directly participated in many reform efforts and assessed all these efforts indirectly, the reform process (and therefore the nature of technical assistance) has also evolved over the years.

The first strand in the EBRD approach to secured transactions reform has been to adopt a regional approach. The Model Law was conceived as an illustration of the principal rules for secured transactions and the way in which these rules can be incorporated into legislation. It emphasises a number of issues where existing legal provisions are likely to be the weakest (such as enforcement and priority ranking). Its great advantage, and one of the reasons for its success, is that it avoids the issue of choosing a particular national legal system as a reference in the context of legal reform. Being “non-national” and neutral, the Model Law aims to inspire not impose. The EBRD’s regional approach is maintained by providing materials of a regional scope in its technical assistance projects, encouraging compatible solutions from one country to another, thus being a short step from harmonisation (which cannot be imposed). Finally, the EBRD has also developed a regional assessment – the Regional Survey of secured transactions (see following) – and intends to expand it to related issues, such as the registration system for charges over movable assets.
The second essential component of the EBRD’s reform methodology is to emphasise the economic objectives rather than the legal form of secured transactions reform, taking account of the EBRD’s position as a future user of the new system. Additionally, the Bank has always acknowledged the importance of taking account of the countries’ different legal traditions and styles and thus adapting any reform undertaken to the existing local framework. The Core Principles that the Bank has developed serve precisely this objective by providing a general formulation of goals for successful reform. These Principles indicate desirable outcomes and assist in building a reform consensus.

At the initial reform stage the EBRD often considers that it is more useful for a country undertaking reform to look at and learn from its neighbours, rather than at other (possibly more developed) jurisdictions, which may not provide the adequate setting for inspiration.

The third component is to provide assistance and encouragement to countries to build capacity to develop their own legal frameworks. The EBRD cannot, and does not, undertake legislative drafting for reforming countries (crude implants of laws, including the Model Law, into the recipient country must be firmly resisted). Where the EBRD’s assistance makes a difference is in providing support and expertise to a locally led reform process. The EBRD’s assistance helps to guide secured transactions reform towards viable results (particularly in economic terms) and helps to identify and reduce obstacles to implementation.

Indeed, the biggest lesson of the past ten years is that technical assistance should not be limited to helping with the drafting of new legal provisions. Rather, it has to embrace the fully economic terms and help to identify and reduce obstacles to implementation. b) Building consensus and understanding

The first element of EBRD involvement in secured transactions reform in the Slovak Republic was to work towards creating a favourable environment for the introduction of effective security laws by building consensus on the rationale for and the objectives of the secured transactions reform. A working group comprising representatives of the main concerned ministries, international organisations, members of the Slovak Bar, courts, academia, the banking association and other concerned agencies was created. Its objective was to define the reform’s broad lines before launching it in the political and legal circles. The EBRD’s role was to explain the economic objectives of the reform and to help build an understanding of the Ten Core Principles. The outcome of the process was a Legislative Proposal debated and adopted by the Government in January 2001. Consensus building was also undertaken with the Government’s Legislative Council, the body responsible for reviewing and making recommendations on all new draft laws before their submission to the Government. It was felt that early presentation of the project to the Council in order to gain its support was essential because some of the Council members were also members of the Civil Code Review Committee that would have to support the reform as an amendment to the Civil Code.

b) Advising on and “stress testing” a draft law and related provisions

The EBRD undertook a more “classical” role in the preparation of proposed Civil Code provisions on secured transactions. The Bank reviewed a number of drafts and focused on the practical effects (“stress-testing”) of the proposed provisions. The project team included a local drafter who, together with EBRD-supported international experts, enabled the principles and objectives previously agreed upon to be adapted and incorporated into the local legal tradition and existing legal system. The new regime included amendments to related provisions of the Civil Code, Commercial Code and Civil Procedure Code as well as amendments to a Notarial Law and preparation of a decree on registration. The EBRD’s involvement was less proactive, relying on a Slovak team led by the Office of the Deputy Prime Minister, the Ministry of Justice and other interested groups to consolidate these amendments into a consistent system.

c) Addressing the institutional framework to implement the reform

As a matter of policy, the EBRD does not fund the creation of the charges registration system.29 In the Slovak Republic the system operator, the Slovak Chamber of Notaries, was selected through an open bidding process. The EBRD helped define the bidding conditions and criteria. The EBRD’s assistance also included defining the structure and functions of the central registration system by helping to prepare a detailed Project Definition Plan. The EBRD role in this respect was that of a gate-keeper, ensuring that the system will serve the public objective of permitting fast, simple and low-cost registration within a secure and reliable framework.

d) Participating in the legislative process

Review by the Government and Parliament of a proposed legislative package is most likely to raise comments and discussions. The EBRD assists in this review process by reviewing comments on proposed legislation with the drafting team and helping to resolve any concerns or conflicts. This assistance can facilitate the legislative process. In the Slovak Republic the EBRD’s assistance was important in convincing the Slovak Government to do away with its preferential tax lien.

e) Maximising awareness of the new law and encouraging its use

The EBRD has also been involved in promoting the new law and raising awareness of its financial benefits in order to encourage use of the law once adopted. The EBRD’s involvement in this ongoing process will include the production of a “practical guide” informing market users of new opportunities, a legal commentary for the legal and judicial audience and “product development” with Slovak banks to encourage credit availability. The Bank will also support the judicial training programmes on the new legal provisions. The EBRD acts as a catalyst, working with and relying on other local or international organisations to promote the new secured transactions system.

f) Monitoring

Last, but not least, the EBRD will be involved in monitoring the operation of the system, in particular the charges registry. By suggesting amendments and minor changes to the system and encouraging a full understanding of the intentions behind the law early in the implementation process, the EBRD aims to serve its role as technical assistance provider and direct user of the system through its banking operations.
Lessons learned for future reform

The outline of EBRD involvement in the process highlights a number of lessons that will be important for future secured transactions reform:

- It is essential to build a consensus among all concerned from the outset on the content and objectives of the proposed law. Consensus implies a full understanding of the "how" and "why" of the issues. It is always tempting to tell the recipient country what to do first and to explain afterwards. However, experience shows that this approach almost invariably leads to little impact; if the champion of the reform cannot justify the legal choices made, the chances are high that the reform will not be adopted or implemented properly.

- Locals should take ownership of the reform; reform cannot ultimately succeed without a clear local commitment and division of responsibilities. First, it should be borne in mind that the reform concerns the domestic law of the country. Therefore, as part of the legislative and democratic process, relevant governmental or non-governmental institutions should lead the reform effort. The objective of legal reform projects should be not only the successful achievement of the specific reform itself but also the development of a know-how and methodology within the country for leading similar projects in the future. Second, local ownership requires the presence of able, dynamic and committed professionals willing to adopt different modes of work.

- Legislative drafting must be carried out by local lawyers in the local language. Indeed, lawyers educated in the country, with an understanding of the economic functions of secured transactions, have the ability to properly introduce the new concepts into existing legal framework. Translating a superbly refined English text drafted by foreign lawyers into the local language does not achieve happy results. Moreover, local drafters should take charge of integrating the reform into all relevant existing provisions in order to avoid issues of inconsistency and incompatibility.

- Technical assistance should also include support for the building of implementing institutions and regulations, such as the charges registry. The users of the law are primarily interested in its practical implications rising out of implementation. Therefore, to ensure proper usage of a law, a well-structured and clear implementation structure should be created and supported by legal reform providers such as the EBRD.

- A law is effective only to the extent it is used: the success of the reform may depend on getting the potential users to buy into it. There may be various ways of achieving this, depending on what is likely to appeal to local market practices and to be upheld by the judicial system. In particular, it is felt that an important success factor for secured transactions reform lies with convincing the local banking sector to change its credit-giving practices, based on the benefits that a new law may bring.

- A law’s success is ultimately dependent on its application and enforcement by the courts. Yet, transition country court systems are regularly described as deficient, slow and often subject to corruption. Although it cannot be expected that the reform of secured transactions law will address these problems, they should not be ignored. Judicial training and court administration efforts could be provided in the context of this reform, as part of a global and sustained improvement strategy.

- Finally, technical assistance in the secured transactions sector is a long-term enterprise, which must remain active beyond the adoption of a law. It is necessary to monitor the law’s functioning against initial objectives, so it can be adapted to evolving practice and so that new implementing institutions can be fine-tuned. This reform process comes at a cost: technical assistance is unlikely to produce quick results that are sustainable. Donors who support the projects of the EBRD and other legal reform providers need to understand that a long-term commitment and flexibility in the use of funds are required for secured transactions reform to be a success. Looking at the future of secured transactions reform, two different scenarios may emerge.

First, the emphasis in the early years was on permitting and encouraging classic secured transactions but allowing maximum flexibility for the parties to cover all types of assets, debts and transactions. However, the current trend is to look at transactions with similar economic purposes (e.g., financial leasing, debt assignment) and at financial transactions that may be built on secured transactions (e.g., mortgage securitisation). Technical assistance will probably be needed to assist the countries that are prepared to embrace these sophisticated international transactions.

Second, in some countries, a pressing need may be a “back to basics” approach: the system that has been adopted in the past few years is not working adequately due to poor implementation or deficiency in institution-building. The EBRD challenge in these countries lies with being able to pinpoint the deficiencies in the system. In this context, the EBRD needs to continue its assessment work while fine-tuning its methods of providing acceptable and concrete tools of rating success.
Telecommunications legal reform

With the increasing globalisation of the world’s economies, telecommunications has become a critical component to general economic growth and development in all modern nations, be they developed or developing. The past decade has seen unprecedented change in the telecommunications sector throughout the globe. Early initiatives by the United States, Canada and the United Kingdom were followed by a wave of liberalising measures introduced by the European Union (EU) and the entrenchment of principles promoted by the World Trade Organization (WTO) and other international organisations. These changes, allied to the increasing convergence of information and communication sectors, the rapid advance of technology, and the advent of the Internet have transformed the telecommunications landscape.

Telecommunications reform in central and eastern Europe and the CIS

Throughout the transition countries of central and eastern Europe and the CIS, the traditional view of telecommunications as a service that merely played a supporting role to general industrial and commercial output held sway until recent times. That view along with the Soviet-era communist governments’ desire to control information flows resulted in significant under-investment and consequential stagnation in the sector across the region. Since the collapse of the Berlin Wall, however, the transition countries have become exposed to the dynamics of the modern market economy and, more particularly, the liberalisation and privatisation policies being pursued within the telecommunications sector in western Europe. From this exposure, it quickly became apparent to these nations that the telecommunications sector is a key industry in its own right as well as being an important instrument of social inclusion. In ten years this realisation, in tandem with the implementation of modern EU and internationally accepted regulatory practices, has resulted in the rapid development of the telecommunications sector in many of the central and east European countries and the CIS.

The EBRD’s role in the sector

Throughout the region during this period the EBRD has been an important catalyst of change with respect to reform and development of the sector. The EBRD has promoted a policy of modern EU and WTO consistent regulatory practices as a precursor to investment. Implementation of this policy necessitated the development of the EBRD’s telecommunications regulatory development programme. This programme currently provides, or has provided, both formal and informal assistance to 16 of the EBRD’s 27 countries of operations. The EBRD assists with the adoption of modern, clear and predictable regulatory frameworks and the establishment of implementing regulatory institutions, with the power and the means to enforce such frameworks. Under the programme, the EBRD provides technical advice on matters such as the establishment of an independent regulatory authority, the rebalancing of telephony tariffs and the implementation of a modern interconnection and licensing regimes. These initiatives have assisted many central and east European countries and the CIS to transform their telecommunications sectors, to begin privatising their state-owned incumbent operator and to open the market for those telecommunications services to competition. These reforms have enabled these countries to gain access to vital capital necessary for restructuring and modernising Soviet-era telecommunications networks.

For example, in Albania the Bank’s assistance led to the elaboration of a telecommunications sector policy, amendments to the telecommunications law to reflect the principles underlying EU policy in telecommunications, preparation of secondary legislation needed for the law to become effective, and definition of the role and functions of the independent telecommunications regulator. This reform improved the regulatory framework, facilitated the successful privatisation of the Albanian Mobile Company (AMC) and directly contributed to the successful award of a second mobile telephony licence. The successful regulatory reform programme enabled the EBRD to enter into a loan agreement with the state-owned incumbent fixed-line operator.

In Kazakhstan the EBRD has provided a three-phase telecommunications regulatory reform project that includes developing a legal and regulatory framework, establishing the institutions needed for implementing this framework and raising general awareness on telecommunications law and policy. With strong Kazakh Government support, the EBRD project has made substantial progress, with the preparation of a concept policy paper leading to the drafting of a new telecommunications law. This new law, when passed, should reflect all major recommendations made by the EBRD in providing for sector liberalisation, the creation of an independent regulator and the initiation of a mechanism that will permit tariff re-balancing without undermining the sector’s development.

Lessons from the EBRD experience for future reform

From central Europe to central Asia, the experiences of the EBRD make it clear that the provision of advanced telecommunications networks and services at low tariffs is a fundamental building block of any modern economy. Simply put, inexpensive, advanced communications are essential to the competitiveness of a modern market economy. However, there can be some complexity in achieving this goal. Some of the essential pre-conditions for success in reforming the sector include:

Appropriate counterpart

One of the most important elements in any reform process is gaining access to the appropriate government counterpart. EBRD experience has shown that reform is most likely to succeed where supported at the highest level of political authority, i.e., an appropriate senior counterpart with direct access to the highest government officials and sufficient ability to navigate the all-too-common state bureaucracy.

Clear sector policy

An unambiguous and consistent sector policy is an essential instrument in guiding a telecommunications marketplace to an optimum (competitive) state and achieving goals such as universal access to basic telecommunications services at affordable prices. The policy should include goals such as legal certainty, a clear and unambiguous timetable for privatisation and liberalisation, provision for universal service (or universal access, where more appropriate), provision for the rebalancing of tariffs and establishment of an independent regulatory authority.

Clarity and legal certainty

The proposed regulatory framework should be based on a clear understanding of the commercial realities underpinning the market and future prospects for its development. To attract the private foreign investment needed to finance the development of the sector, opportunities offered to investors must be clearly elaborated in the laws, regulations, licences, concessions and privatisation contracts. Private investors may be willing to bear commercial risk but they tend to recoil from political risk that they cannot easily factor into their financial calculations for assessing investments.
Independent national regulatory authority

A key element of a stable telecommunications regulatory framework is the establishment of an independent sector-specific regulatory authority. With the onset of the new telecommunications regimes, as promoted by the EU and WTO, regulation by a single ministry making decisions about policy formulation, implementation and network operation is clearly inappropriate. Telecommunications privatisation and liberalisation will create a new market dynamic necessitating a more modern, transparent and accountable method of regulating the sector. The now widespread EU/WTO-style sector-specific regulatory authority, independent of either political or operational influence, has emerged as the sine qua non of sector reform. The role of such a regulator is to ensure that competition can emerge using methods well adapted to the needs of the sector, and which should enable the sector to develop without the necessity for individual action by market participants to establish entitlements. Primary legislation should spell out the regulatory rules, functions, processes and procedures that will govern its interaction with the marketplace.

Early liberalisation

It is widely acknowledged both inside and outside the telecommunications sector that consumers are better served under competitive conditions. In telecommunications, for this to occur it is necessary to relieve the state-owned incumbent operator of their traditional exclusivity rights and allow new market players to compete in the provision of networks and services. Liberalisation is needed to realise the full benefits from increased private participation. While full liberalisation is the goal, the speed and level at which it will occur will differ from country to country and will depend on individual national policies. Nonetheless, a clear, concise and unambiguous timetable for liberalisation is essential, for without this, prospective investors will not be in a position to accurately assess the potential for investment.

Rebalance tariffs

Traditionally, within the transition countries existing telephony tariffs can be substantially out of line with the cost of providing telecommunications services. Because unbalanced tariffs are not sustainable in a competitive marketplace, they will need to be rebalanced to an appropriate level before full liberalisation. Rebalancing is a critical element of the reform process; the price an operator is allowed to charge its customers is the most important determinant of profitability and ability to finance growth.

Implement a modern and workable interconnection regime

Telecommunications systems are somewhat unique in that the value of a connection to a single subscriber increases with the number of other subscribers connected to the system. Thus, a new operator’s ability to reach and be reached by customers of the existing operator and to use parts of existing networks, in a timely manner and under reasonable technical and price terms (rather than replicating the incumbent network) is critical in determining both its own viability and the economic efficiency of the sector overall. Interconnection is, thus, the lifeblood of competition in the sector. Accordingly, the obligation of dominant operators in this respect, the principles under which terms of interconnection will be negotiated, and the process and timetable for a regulatory decision in the event of dispute must be clearly spelled out and implemented effectively.

Conclusion

A decade on, the core principles of regulatory reform have been tried and tested and are now establishing firm root in many of the central and east European countries and the CIS. Much can be learned from the experiences of the EBRD and other regulatory reform providers. This experience makes it abundantly clear that while major politically based reform initiatives, such as liberalisation and privatisation, tend to drive the reform agenda, the process needs to reach well beyond these initiatives. While “one size may not fit all”, establishing a transparent, fair and level playing field, following the “rules of play” and honouring commitments helps establish and perpetuate an environment for competitive provision of service. Crucial also for any reform endeavour is the ability to develop a regulatory capacity that can adapt to an ever-evolving market place and that will take every opportunity to promote and enhance competition in pursuit of both development and commercial objectives.
A reformer’s lessons learned: The case of the Slovak Republic

This article explores lessons learned from the Slovak transition experience over the past four years focusing on the need for political support and human capacity in making legal reform progress. It discusses the successes and setbacks in three areas: amendments to the Commercial Code (reform of company law), introduction of a new Labour Code and a new collateral law system. The article offers an insight into the legal reform process from the perspective of a country pursuing a reform agenda.
Beyond technical solutions: political support and human capacity

For a reformer in a government of a transition country, there are two greater challenges than figuring out the technical solutions needed for reform. One is to design and implement reforms that are politically palatable and that will receive sufficient political support, including the backing (or at least non-opposition) of special interest groups. This is especially important in the latter part of the transition when the population has become increasingly disillusioned with the reform process and when the various interest groups are clearly defined. The other challenge is to ensure that there are sufficient human resources to design, develop and implement the reforms. This is a tall order in countries where the state administration has not been reformed or reorganised and where state officials are expected to support reforms and build institutions for a market economy – tasks for which they are ill-prepared or resent in principle.

Twelve years into the transition, policy makers in central and east European economies can tackle most reform issues with well-established technical solutions or a set of feasible policy options.7 The lessons learned throughout the past decade, which have been well documented in academic and popular literature, outline the policy options and present the measures needed to achieve stability and economic growth and to build the necessary institutions for a functioning market economy. In addition, the international institutions involved in advising and coaching transition governments, such as the Organisation for Economic Co-operation and Development (OECD), the European Union (EU), the International Monetary Fund (IMF), international development banks and bilateral donors, are more than happy to fly their experts into countries to present their versions of what needs to be done and by when. A World Bank report entitled Transition–The First Ten Years, offers useful commentary on the successful reformers within central and eastern Europe that managed from the outset to promote discipline among the key players in the economic process, as well as encourage new entrants into the market.8 The report contrasts the successful reformers with the “laggards” of transition, who, instead of implementing the “discipline-and-encourage” strategy, continue to protect socialist industrial and financial enterprises through taxes, budget or energy subsidies and various preferential policies, and to discourage new entrants into the market with high administrative and tax barriers.5

A government reformer who has the technical solutions readily available is in a very different situation from one at the beginning of transition where most reforms were based on nothing more than trial and error. However, while the pioneer reformers of the early 1990s were not certain of which reform path to take and which to avoid, they were able to test various reform efforts and policy options. Their reform efforts were not as strongly hampered by the existence and influence of special interest groups. The former socialist industrial managers were still finding their renewed strength and representatives of new interests were looking for their voice. Now in the later stages of transition, the technical solutions are in place but reformers are facing a new obstacle – a need to battle interest groups (old and new), while being confronted with the growing apathy and impatience of the population.

Supporters and opponents of reforms: timing is everything

Recent analyses have highlighted that for the reform process to succeed, transition countries need to build political reform constituencies and gain the necessary public support for the reform process.9 The World Bank report Transition–The First Ten Years also recognises the importance of the political aspects of reform. It argues that competitive political systems have a better track record in successful economic development. It highlights the conditions conducive to reform and illustrates which constituencies are likely to embrace reforms and which are likely to oppose them. The report also upholds the theory that “early winners” of transition reform (groups that benefited from the partial reforms introduced at the beginning of transition) are hostile to, and often oppose, the continuation or later introduction of further reforms.4 There are various examples of “early winners”, from industrial managers who, as a result of the collapse of communism and the weakening of the central state administration, had the free rein to run their enterprises, to bank managers who could suddenly loan large sums of money to their friends and cronies. Stories like these were commonplace in many, if not all, transition countries.
In the short term, reform is often painful and difficult for the population and even in the later stages of reform understanding and adjustment are not easy. Therefore, politicians frequently take the easier route of not embarking on short-term reform forcing their successors to worry about the long-term consequences.

A telling example of the resistance to change and preference for the status quo by the “early winners” in the Slovak Republic is the attitude of the bar association to further reform of the legal profession and the judiciary. Legal practitioners, who are by no means the only example of “early winners” in the Slovak Republic, benefited enormously from the liberalisation of the profession in the early 1990s when all legal services became private entities. The bar association is currently actively opposed to further liberalisation such as opening up the market for legal services to foreign competition and is relatively passive in relation to the reform of the judiciary. It seems that the current practice of often arranging the outcome of litigation through connections, rather than the quality of legal argument, is easier and more beneficial to many lawyers.

In their book on Russian reform, Without a Map: Political Tactics and Economic Reform in Russia,7 A. Shleifer and D. Traisman similarly recognise the crucial importance of the politics of reform. They explain the reform process in Russia as a continuous battle among divergent interest groups referred to as “stakeholders”. Such groups include state officials, enterprise managers, employees, local and regional officials, bankers and media moguls, all of whom oppose reform for various reasons. According to the authors, government reformers either have to quash the stakeholders (“expropriate” them) or ensure they buy-in (“co-opt” them) both at the reform planning stage and at the implementation stage.8 They take the politics of reform contention one stage further and argue that the relevant framework for comparison of the success of a reform is not to compare reforms with an ideal outcome, but rather compare the existing outcomes with their politically feasible alternatives.

The EBRD Transition report 1999 states that “politics is to blame” when reforms have not taken place or are insufficient.9 In the short term, reform is often painful and difficult for the population and even in the later stages of reform understanding and adjustment are not easy. Therefore, politicians frequently take the easier route of not embarking on short-term reform forcing their successors to worry about the long-term consequences.10 Experience in the Slovak Republic supports the notion that, despite the merits and quality of a reform proposal it may falter at the implementation stage or may not even be adopted if it has not gained sufficient political support.11 It is often more advantageous to design or adapt policies resulting from political compromise than to go for a “perfect” solution and risk not having the reform adopted at all. A prime example is the privatisation programme in the Slovak Republic in 1999. Under the pre-1998 Government, several sectors of the economy, including banks, insurance companies and utilities, were declared “strategic enterprises”12 and were thus excluded from privatisation.

Initially, the Government coalition13 agreed that the law stipulating this would be abolished and all companies would eventually be privatised. However, during the parliamentary process the ex-Communist party – a member of the broad ruling coalition – decided not to support the plans for full privatisation. After several days of parliamentary debate and following threats that the ex-Communist Party would withdraw from Government, the rest of the coalition agreed to compromise by capping the stake of utilities slated for sale at 49 per cent, in exchange for the full privatisation of government stakes in all the state-owned banks and insurance companies. This imperfect solution upset many in the Government, the press and the public. However, it proved to be a stepping-stone in enabling future governments to press ahead with the full privatisation of both the financial and utility sectors. Adjusting the original policy to get full political support for the “imperfect” solution has indeed been worthwhile.

As has been demonstrated, politics are important in ensuring the design and implementation of reforms. The existence of government reform groups; the ability for a coalition government to agree on policies; the existence of political competition and the free press pushing politicians to make responsible choices; the ability to maintain public support; or the ability of government reformers to convince or defeat special interest groups are all preconditions to wide-reaching and systemic reform. As was the case in the Slovak Republic in 1998, it took a general election for all of these elements to come together and open up what commentators refer to as a reform “window of opportunity.”14

Who will carry out the reforms? Help wanted

Another important factor underpinning the success or failure of reform is the existence of sufficient professional human resources, or in other words, the ability of key individuals to formulate policies and design, develop and implement the tasks that will bring about reform. The lack of human capacity in transition countries is often overlooked. It is hard for the commentators of well established Western democracies to imagine a situation where advertisements for a head of a newly established network regulator or a debt reduction agency fail to generate a well-qualified pool of individuals.

Over the past four years in the Slovak Republic, while difficult, it was ultimately possible for the broad governing coalition to agree on a reform agenda, with a few notable exceptions.15 It is the author’s belief that it was the lack of qualified and talented individuals, rather than the lack of political will or a blockage imposed by interest groups, that limited the scope and speed with which reforms could be carried out.

Some of the human resource issues in the public sector may be specific to the Slovak Republic, but many are likely to occur in other countries. At all levels of the public sector from policy makers to operational staff, there is virtually no foreign training or expertise. The lack of cross-fertilisation of ideas and knowledge that come with exposure to foreign educational systems and work experience is more pronounced in the legal, economic and accounting professionals working in the government. The Slovak Republic has traditionally had a particular problem with a large brain drain. Under communism the destination was the West, now it is usually the Czech Republic. There are clearly insufficient incentives, moral and financial, for Slovaks with education and experience abroad to come back and work with the Government. This makes the situation very different to Serbia, for example, where a great number of people returned immediately after the fall of the Milosevic regime to work for the current Government.

While the constraints on human resources are most visible in the public sector, this problem is not exclusive. The various trade associations regulating private professions have similar problems, as outlined on the following pages. Such is the legacy of the Mečiar era, when government and business were closed to anyone...
who did not support the former Prime Minister, that many of the Slovak Republic’s most talented and educated individuals occupy positions in the non-governmental organisations.

The lack of English language proficiency among those in key positions within the public sector, for example among ministerial staff, further compounds the problem of human resources.16 Usually, the only English speakers are in the sections that are focused on forging relations internationally and with the EU. Most of the non-English-speaking ministerial staff end up working in a different policy, knowledge and even value environment from those who have been exposed to international experience and contacts. This turns every reform dialogue into a challenge when many concepts and reform goals are impossible to communicate accurately. Conversely, a vast majority of the people in the non-governmental organisations and think-tanks are fluent in English and are able to benefit from and contribute to the global discourse.

Can foreign advice and assistance help?
An absorbing issue

Before donor attention and resources shifted away from central Europe to southern and eastern Europe, the public sector in the Slovak Republic, to a large extent, failed to benefit from foreign advice and assistance. This was due to the isolation during the Mečiar years, during which the Slovak Government was not open to donor advice nor welcoming of international assistance programmes. It has also imposed a rigorous schedule in place for reform efforts that would otherwise drag on. At the same time, the accession process, especially the harmonisation of the national legislation with the EU acquis communautaire, can be rather formal, especially when accession countries lack the human resources to absorb advice and implement necessary reforms. As a result, the accession process, at times, risks missing the desired outcome.

If carried out properly, through assistance programmes, donors can often boost domestic capacity and expertise in critical areas. However, there are also risks. Foreign experts sometimes lack the ability to translate the considerable expertise in their field into the local context and do not know how to work effectively with locals. Sometimes, the donor agenda may be biased, exporting their home expertise with insufficient regard for the local context. Yet another problem may be that some foreign donor programmes are more an employment agency for their nationals than assistance for transition countries.

Despite such difficulties, the top economic policy makers and institutional reformers in the current Slovak Government have benefited from international policy advice and guidance. The reform dialogue with the World Bank, IMF, OECD, EU and bilateral contacts, helped anchor the policy agenda of the Government. Many good policies and Government decisions were prepared in consultation with these institutions or benefited from their advice. Also, they provided the critical support that made the adoption of some difficult decisions possible, such as the Slovak Republic’s commitment to invest roughly 12 per cent of its GDP into restructuring the banking system.

The key process in all central European countries and Baltic states is accession to the EU. While often burdensome and unwieldy, it can provide useful policy guidance for the transition countries and can be of particular importance in instances of internal political debates and disputes over various policies by breaking political impasses and promoting political consensus. It also imposes a rigorous schedule in place for reform efforts that would otherwise drag on. At the same time, the accession process, especially the harmonisation of the national legislation with the EU acquis communautaire, can be rather formal, especially when accession countries lack the human resources to absorb advice and implement necessary reforms. As a result, the accession process, at times, risks missing the desired outcome.

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The key process in all central European countries and Baltic states is accession to the EU. While often burdensome and unwieldy, it can provide useful policy guidance for the transition countries and can be of particular importance in instances of internal political debates and disputes over various policies by breaking political impasses and promoting political consensus. It also imposes a rigorous schedule in place for reform efforts that would otherwise drag on. At the same time, the accession process, especially the harmonisation of the national legislation with the EU acquis communautaire, can be rather formal, especially when accession countries lack the human resources to absorb advice and implement necessary reforms. As a result, the accession process, at times, risks missing the desired outcome.

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Ingredients for reform: three concrete examples

Three recent reforms outlined below illustrate the effects the issues discussed in this article have had on the reform effort. Each of the three examples, the new company law, 17 the new Labour Code, 18 and the reform of the collateral regime, 19 have a significant impact on the economic and institutional development of the country, as noted by the OECD, the World Bank and domestic commentators. 20 The first and third examples have a positive outcome, while the second represents a reform failure. The three reforms illustrate different, though interrelated, lessons.

1. The new company law

Company law reform was championed and prepared outside of and initially against the resistance of the regular state administration structure, the Ministry of Justice (MOJ). Despite a difficult beginning, and unlike the case of the Labour Code, company law reform ended as a success. Unlike the collateral reform, however, the company law reform did not benefit from well-structured and effective donor assistance and the private sector was not actively involved in the preparation and adoption of the reform. The company law reform process clearly revealed gaps in the Slovak Republic’s skills base and the inability of private sector groups to get their legitimate interests represented in the legislative process.

The EU Company Law Directives 21 deal with important issues such as the maintenance of capital, the registration of companies, publication of company information, and mergers and acquisitions. They, do not, however, deal with the crux of company law, for example, the type of companies, their structure, the relations between the company and its directors and officers, or shareholders’ rights, including minority shareholders. These issues, which arguably are central to the proper and effective functioning of company law, are regulated and sanctioned by the national legislation of the individual EU member states. This means that even with full harmonisation of all the relevant provisions of the Directives, Slovak company law would not necessarily be compatible with standards found in the member states or those expected of a future member. At the start of the process of harmonisation in this area at the end of 1999, the Slovak Government paid little attention to issues outside of the Company Law Directives. Harmonisation was seen purely as a mechanical process of transposing the relevant provisions from the Directives into Slovak law.

It was not until the Deputy Prime Minister’s office – a key player behind the Slovak accession to the OECD – started to take an active role that the company law reform agenda was considerably broadened. In addition to harmonisation with EU law, the Cabinet agreed to incorporate the OECD Principles of Corporate Governance into the company law in order to make the legislative environment for economic activity more transparent and predictable. The new company law (an amendment to the Commercial Code) was thus drafted using EU law and OECD principles as guidance. The new law was adopted in early Autumn 2001 and entered into force on 1 January 2002.

What contributed to the success of this reform? What impeded it?

The existence of a champion of the company law reform contributed greatly to its success. The Deputy Prime Minister for Economic Affairs and his team argued the case for predictability, transparency and, ultimately, economic efficiency, and convinced the Cabinet to expand the mandate of the MOJ in the company law reform to include the OECD Principles of Corporate Governance. This was achieved through preparation and progression through the full intergovernmental process of a policy document, or “blue print” for institutional reform for a market economy, entitled Improving the Legal, Regulatory and Tax Framework for Entrepreneurship and Investment. 22 The document was necessary to force an agreement among Cabinet members to review the legislative framework for a market economy and expand the legislative reform process beyond strict EU harmonisation requirements. Had it not been for this intervention, the MOJ would have put a great amount of effort into preparing a piece of legislation that would have lacked fundamental elements of corporate governance, such as directors’ and officers’ liability, information duties in relation to shareholders and other stakeholders, and the introduction of shareholder action, thereby missing the important elements of market economy transition.

Initially, the MOJ was resistant to the changes and did not welcome the expanded mandate. Therefore, it was necessary to make it identify with the reform through a Cabinet decision. It soon became apparent that the underlying reason for the hesitation in tackling the broadened agenda for reform was the fact that the Ministry lacked sufficient staff with the necessary understanding, knowledge, and experience. The notion of corporate governance was an alien concept to the predominantly non-English speaking lawyers in the MOJ. 23

The Ministry created a drafting committee for the company law that consisted mainly of judges and some MOJ staff. Their input was critical and the author strongly believes that judges should be given the opportunity to comment on draft legislation as frequently as possible. This is especially true in the civil law countries where so much of law implementation and enforcement hinges on the quality of draft legislation. The problem in the company law case was that, as most people who have ever been part of a legislative process will acknowledge, legislation cannot be drafted by committee. A committee can review, comment and brainstorm on specific provisions, but every piece of legislation needs a dedicated draver (or small group of drafters) to produce the first draft. This role was initially missing from the committee process and therefore, very little was achieved in the first year and a half. Consequently, the entire drafting process experienced difficulties in meeting the EU accession-mandated deadlines. In response, the reform team around the Deputy Prime Minister identified and retained an experienced lawyer with an academic background who later became the principal draver of the entire Commercial Code amendment. This was the solution “outside of regular structures” that made the full company law reform possible.

With its serious capacity constraint it is unfortunate but not surprising that the MOJ’s attitude towards harmonising legislation was initially rather formalistic. This is frequently the case when transposing the EU acquis communautaire throughout the accession countries. Overwhelmed by the complex harmonisation process, countries tend to transpose the “letter”, rather than the “spirit” of the Directives. The danger is even greater in traditionally formulaic legal cultures such as those found in central Europe. It may be that more of “coaching” approach by the EU negotiating and review teams could help the countries overcome this shortcoming. Such an approach might breathe more “spirit” into the transposed legislation, particularly in instances where – such as in company law – the member states themselves have not yet reached an optimal level of harmonisation.

An important aspect of the adoption of the company law was the conspicuous lack of input by the private sector. This was the case despite the effort of the drafting team to solicit comments both from private lawyers and the business community. The Slovak legislative and policy-making process has become rather more open over the last four years. As the various drafts of the law evolved, they were all accessible via the MOJ Web site and many businesses, associations, chambers of commerce, large foreign and domestic investors and large legal offices were approached for their comments. Many of those contacted felt that the Commercial Code amendment with its 300 new or revised provisions was too large and complicated to comment on. A curious attitude from lawyers and business people for whom the Commercial Code is one of the, if not the, most important pieces of business regulation. As will be seen with the Labour Code, business associations and groups representing legitimate interests of the business
community that would be interested in and capable of producing timely feedback to the legislative process are still in a nascent stage of development in the Slovak Republic.

2. The new Labour Code

The Labour Code is an example of a reform failure on many fronts. Unlike the other two successful reforms described here, it did not have a visible champion in the Government. The Labour Code was prepared by the Ministry of Labour and Social Affairs (MOL), an entity both strongly resistant to change and market reforms and lacking in professional skills to prepare modern legislation. Unlike in the collateral reform case, there was no effective donor assistance in the preparation of this Code. Perhaps even more importantly, as with the company law (and unlike the collateral reform), the private sector and professional associations were not sufficiently involved in the preparation of the Code.

The Slovak Republic carries the gloomy distinction of having the highest level of unemployment among the EU accession countries, at approximately 18 per cent in July 2002. While no single factor can be pinpointed as the cause of this situation, both domestic and international commentators agree that the rigidity of the Slovak labour market and insufficient labour mobility are among the main causes of high unemployment and low levels of job creation. Unfortunately, the Labour Code as proposed and adopted further diminishes labour flexibility; makes labour more costly; restricts the hours and overtime one can work; curtails the ability to work part-time; contains disincentives for further hiring; makes reorganisation harder and more costly; and significantly increases the role of trade unions in the operation of companies in ways that are mostly beneficial for trade union functionaries.

The MOL took two years to prepare the Labour Code. During that time, the Code went through a full legislative process where it was vetted several times by the executive, examined several times by the Tripartite Council (comprising the Government, the trade unions and the employers), and read three full times in the parliament. Through the entire process no one seriously objected to the Code as a whole. It was adopted by the parliament in Summer 2001, with an effective date planned for 1 April 2002. Only several months after its passage, in late autumn 2001, did various chambers of commerce and associations of employers start criticising the new Code as one that would hinder economic development and contribute to the continued low employment situation in the Slovak Republic.

In early 2002, under pressure from the business and investment community, both domestic and foreign, the Deputy Prime Minister agreed to coordinate the preparation of a “quick fix” amendment that would be adopted prior to the effective date of the new Code. This, in fact, took place and on 1 April 2002; the new Code came into force, together with its new amendment. The new amendment improved the Code somewhat (the allowable overtime hours were extended from 48 to 58; the professions dependant on irregular work schedules, such as transport, cultural and medical workers, were allowed broader exceptions to the rigid rule on work time; the option of part-time work contracts was reinstated) but it failed to transform the Code into a truly solid modern framework for labour relations.

Why was a faulty Labour Code adopted and why did no one object?

There are several reasons. First, one needs to understand who was behind the Code as drafted, and whose interests the Code serves. Second, one needs to examine whether the preparation of the Code was done in the open, and verify if there was a chance to influence its content. Third, one needs to look at the competing interests and see whether they were adequately represented.

The MOL, an entity reminiscent of the communist era in its physical appearance and work practices, prepared the Code to reflect their ways of thinking. In other words, the State should govern and if that is no longer possible by being the universal employer, then one compensates for it through legislation severely restricting the scope for private agreements. The MOL claimed that one of the key motivations behind the new Code was the desire to increase employment. The logic was such that by legislating the restriction of overtime, employers would hire more workers and unemployment would decrease. The trade unions, with their old-line representation and dramatically decreasing membership and popularity among the workforce, happily cooperated in the preparation of the Code. From the point of view of trade unions, the Labour Code broadens their influence in the management and operations of enterprises.

The draft Code was accessible to the public via the Internet early in the legislative drafting process. Moreover, it was made available to the employers’ associations even earlier by way of the Tripartite Council. In a mature and well-functioning democracy, legitimate business interests with their own well-established channels of communication and influence would normally provide a counterbalance to the role of trade unions. Unfortunately this did not occur. The failure of all the relevant parties to comment on the Code was not caused by lack of access. The Labour Code was by no means a backroom deal cooked up by a circle of insiders in a matter of few weeks.

19 Hereafter, the terms “collateral” and “secured transactions reform” are used interchangeably.
22 Adopted on 13 September 2000, as Cabinet Decision No. 703, Document No. 2024/2000. The preparation of this document was aided by the legal and institutional content of a World Bank loan and by a Foreign Investment Advisory Services (part of the World Bank) study on barriers to foreign investment. This document was limited in scope and did not cover all the legislation necessary for developing market institutions. It did, however, touch on the important building blocks, such as the Civil, Commercial Codes and alternative dispute resolution.
23 The Slovak language – as all other Slavic languages – does not have words that directly translate the English words and phrases such as “governance” and “corporate governance”.
25 To achieve the political backing of the MOL and the ex-Communist party, represented by the Minister, for the passage of the partial amendment, a compromise was necessary; trade union rights remained untouched.
The problem with access to credit in transition countries often constitutes a major obstacle to economic growth early in the transition process.

The Code passed the Cabinet and the parliament, so it may seem that there was sufficient political will and political backing for its adoption and that this important legislation was a result of a broad political consensus. However incredible as it may seem, the Code passed through all the legislative channels without an appropriate analysis of its contents and implications. At each stage of its review, the Code’s implications were underestimated by all involved. Potential participants in the process seemed to be counting on others to analyse the legislation and make appropriate comments representing the interests of all relevant parties. As in the company law amendment, the draft was considered by many to be too onerous to read.

The pace of reforms and the need for legislation was extremely demanding, especially due to the EU accession legislation that had to be passed during the election term. Both the executive and the legislative branches were overstretched and facing a lack of skilled staff. Parliamentary deputies only acquired their first assistants in 2000 before which time they worked without any professional support. Yet, not paying due attention to such a crucial piece of legislation is inexcusable, despite the limited capacity of the executive and the parliament.

The drafters of the Code had no interest in a broader consensus-building effort, because they instinctively felt that they would not get far. It was thought that once word got out about the proposed content of the draft Code and the press and business people homed in on it, the private sector would mobilise itself and lobby (probably successfully) against the Code.

The fact that the Code went essentially unnoticed through its long legislative process is extremely damaging to the private sector, especially large companies, Enterprise managers (and other large employers) need to retain workers with flexibility; they must be able to restructure companies (which may involve redundancies). It is, therefore, extremely surprising that private companies, including large foreign investors in the Slovak Republic, failed to organise themselves sooner to comment on the draft Code. They “woke up” only several months after the passage of the Code, as the effective date was getting closer.

Surprisingly, half a dozen employers’ associations were part of the negotiations on the content of the Labour Code during its preparation as part of the Tripartite Council. These, however, are precisely the kinds of interest groups that resent, or are not interested in, the progressive reforms that lead to increased competition, create predictable and transparent rules, and promote a market that makes it easier for new enterprises to enter. Functionaries in employers’ associations tend to be ex-socialist enterprise managers who partially transformed themselves to the post-communist marketplace, a classic example of “early winners” in a transition economy. It is likely that it is still more attractive for these “winners” to work to further their limited interests than to devote energy and resources to developing a modern and well-functioning company law and Labour Code.26

3. Collateral reform

This is an example of a successful reform that was also championed and prepared outside the usual state administration structure (MOJ), as in the case of the company law. Unlike the latter, however, donor assistance in this case proved very useful and efficient. Unlike both of the previous cases, the private sector (the Chamber of Notaries, law firms and commercial banks) has been actively involved in the preparation and adoption of the reform. Also, a comprehensive consensus-building effort, not seen in the previous two reforms, assured almost seamless passage of the collateral reform through the legislative process.

The problem with access to credit in transition countries often constitutes a major obstacle to economic growth early in the transition process.27 Most of the central and east European countries28 have introduced some collateral regime reform over the last decade. The Slovak Republic started its reform in this area relatively late, in 2000. The legislative and institutional changes had a two-year gestation period. Approval of this reform involved three distinct Cabinet actions. The Cabinet first adopted a concept outline in a broader policy document, then a legislative concept with details of the reform and, finally, an actual draft Civil Code amendment.

How did the reform come about? What were the factors that contributed to its successful outcome? What were the impediments to the reform?

Secured transactions reform is exclusively economic in content and rationale. From a legal or legislative point of view, there is no need for the arcane provisions regulating the creation and existence of a “non-possessory pledge”,29 a term that is sometimes hard to explain even to lawyers.

The collateral reform in the Slovak Republic is a story with a positive outcome. At the time of writing, a major amendment to the Civil Code, the main building block of the legislative changes, was adopted by parliament. The Chamber of Notaries, the entity selected to build, operate and finance a pledge registry, was busy building it. Members of the business community are becoming increasingly aware of the forthcoming legislative changes that will help them get easier and faster access to credit.

Lastly, private banks, operating in an increasingly competitive environment, are looking forward to using the new law to expand their portfolios. The following paragraphs lay out the necessary elements that made the collateral reform a success as well as identifying constraints in the process. These lists apply not only to collateral reform but to a successful legal reform process in general.

What are the necessary ingredients for reform to take place?

■ The existence of a champion of the reform, the Deputy Prime Minister (DPM) for Economic Affairs and his team, who managed to put together a few committed individuals to help develop the reform idea, gather support of a donor, draft the necessary legislative changes, as well as prepare the groundwork for establishing the registry of pledges.

■ Securing a policy agreement among the principal economic reformers (the DPM and Minister of Finance) on the necessity of the reform. This reform was part of a package under the general reform policy umbrella of an Enterprise and Financial Sector Adjustment Loan (EFSAL) agreed between the Government and the World Bank. The fact that the collateral reform was part of a broader reform plan helped defeat the scepticism and resistance to the reform on the part of the considerably more conservative legal establishment, including the MOJ. An important factor in moving ahead with this planned reform was the reform team’s promise it would use outside resources to prepare the reform, and would not rely on the over-stretched human resources of the MOJ.

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Indispensable to the reform was the effective assistance from a donor, the EBRD. The EBRD team provided timely and active guidance on the legislative part of the reform. Essential elements of the cooperation between the local team and the EBRD were, first and foremost, the ability of the EBRD to listen to their local counterparts, coach the overall process, and engage local teams in discussions, while letting them find the most appropriate drafting solutions. Another crucial element of the EBRD’s advice that made its assistance a success, and one that donors often overlook, is that the EBRD remained involved with the passage of the legislation through parliament, and will remain involved in its subsequent implementation.

Effective to the reform was the identification of a domestic drafter to interpret the EBRD’s advice and turn it into Slovak legislative language. While finding the drafter was critical, it also presented one of the main constraints – lack of human resources to develop and implement reforms. The drafter was often overstretched and was acting as the principal drafter also for the new company law.

Effective, although time consuming, consensus-building and dissemination of information about the reform. Consensus-building was necessary to ensure the successful introduction of a new legal concept into a very conservative legal environment. The challenge rested on the need to explain to groups of legislative drafters and policy makers why a non-possessory pledge was important for economic activity in the Slovak Republic. The situation was further complicated by the fact that neither Germany nor Austria – the two countries that Slovak lawyers usually take for inspiration – have similar provisions on secured financing, and yet they are rich and successful economies.26 The Slovak Republic now had a chance to leapfrog the developments in Austria, Germany and other continental Western jurisdictions and introduce very modern legal concepts, a scary prospect for the traditionalist Slovak lawyer. The consensus-building process helped overcome this fear.

The reform generated an agile and influential, yet inexperienced, private group – the Chamber of Notaries. The Chamber, selected by tender to run the pledge registry, used the example of the Hungarian Chamber of Notaries that has successfully operated a similar registry since 1996. The Slovak Notaries, who will benefit from the reform through considerably increased business in the near future, helped clarify the demand for the reform and promote it. They also provided the necessary support to ensure that reform passed through the parliament intact and participated in the preparation of the implementing regulations.

**What were the constraints to the reform?**

- The lack of human resources posed the main hindrance to the reform group. The company law and collateral reform efforts had overlapping schedules for preparation and adoption. As a consequence, the amendment to the Civil Code was adopted with literally only hours to spare before the parliament closed its agenda prior to the autumn 2002 elections.

- While the Notaries were helpful in lobbying parliament for the reform, they required a great amount of handholding and detailed assistance in their relationship with the private company supplying the registry and in developing an appropriate regulatory framework between the Chamber and the MOJ, their governmental supervisory body for running the registry. This highlights that the lack of human resources is not limited to state administration but it is also a problem in the private sector as well.

- The MOJ’s lack of human resources became evident in their supervision of the Chamber of Notaries. The MOJ found it difficult to carry out their new duties vis-à-vis the Chamber; MOJ staff were sometimes daunted by the amount of effort required to draft and implement decrees and in establishing the appropriate procedures for overseeing the operation of the public registry of pledges.

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26 As an indirect result of the inability to make an impact on the content of the Labour Code, a group of enterprises and banks, under the leadership of a prominent economic think-tank, created an Alliance of Entrepreneurs of Slovakia (PAS). According to their mission statement, PAS is dedicated to making an impact on business regulations by commenting on pending legislation. For more details see www.alianciapas.sk. While this may be a positive outcome from the Labour Code, one can question whether the passage of a retrograde code is too high a price to pay for the creation of an effective business lobby.

27 The realisation that modern secured financing techniques needed to be introduced to ensure that enterprise reform and economic recovery were possible throughout the region led the EBRD to launch a secured transaction project in the early 1990s with the drafting of a Model Law on Secured Transactions. For more information see www.ebrd.com/pubs/index.htm or www.ebrd.com/st.

28 Among the notable exceptions were Bosnia and Herzegovina, Croatia, the Czech Republic, the Republic of Serbia and the Slovak Republic.

29 “Non-possessory pledge” is a pledge in which the pledged asset does not need to be transferred to, or deposited with, the secured creditor. In other words, the pledgor (the debtor) does not need to transfer “possession” of the pledged asset to the creditor. For example, a trucking company can create a non-possessory pledge over its trucks to receive bank financing, it can then keep using the trucks to make deliveries, rather than having to park them in the bank’s car park.

30 One had to explain to the lawmakers that private financing works in these countries in spite of the lack of the provisions on non-possessory pledges in their Civil Codes, not thanks to it. On the European continent, the markets have forced over time the development of various exceptions and substitutes to the general prohibition of a non-possessory pledge.
Conclusion

This article is not about the content of reforms, but about the process, the “how to” element of reforms. Each reform government, whether in the Slovak Republic or elsewhere, needs to keep in mind that it is not only the design and content of reforms that matter. The potential obstacles, constraints and challenges to the reform process need to be borne in mind too, if reforms are to succeed.

In summary, the elements of the reform processes that contributed most to the success of the reforms described in this article were: (i) the existence of a champion of reform with a broader reform strategy, rather than haphazard changes to legislation; (ii) wide consensus-building effort around the reform goals; (iii) active participation of the private sector; and (iv) effective donor advice.

With many of the transition reforms already undertaken, the population’s demand for more reform is likely to decrease and their tolerance for radical reforms will diminish. It will also be more difficult to overcome the entrenched powerful interest groups and lobbies. This will constitute the biggest challenge for the next government in the Slovak Republic that still faces a considerable unfinished agenda, especially in reforming the social sectors. The situation following September 2002 will be quite different from the one four years ago, when there was almost a universal consensus on the need to remedy the policies of the previous four years. Despite this rather gloomy prediction, there is a powerful engine for the continuation of the reforms for the next Slovak Government – the "strait-jacket" that the EU accession process imposes on EU hopefuls. Integration into the EU is the single most dominant desire uniting all political parties and it commands a high degree of support among the population. This process itself ensures that a number of reforms will be undertaken in order to take the Slovak Republic further along the transition process.
Three foundations of the rule of law: education, advocacy and judicial reform

Since the start of economic and political changes in central and eastern Europe in the early 1990s, donor institutions have been contributing to the improvement of the rule of law. This article looks at the work presently being carried out and expands on the areas where future efforts should be placed to enhance the efficiency of legal frameworks and the functioning of judiciaries throughout the region.
In late 1999 and early 2000, the author, on behalf of the World Bank, interviewed leading judges, lawyers and law professors from five countries in central Europe and the Commonwealth of Independent States to assess the future of legal and judicial reform in the region. The resulting report recommended six areas of focus for both reformers and donors, including:

- streamlining the legislative framework;
- increasing emphasis on enforcement;
- improving access to justice;
- accentuating legal education reform;
- continuing judicial reform; and
- combating corruption.

Sadly, subsequent visits to the region have revealed that the conditions that led to these recommendations remain in place. The legislative frameworks, particularly in countries such as Romania and Ukraine, remain contradictory and confusing. The implementation and enforcement of new legislation remains haphazard throughout the countries visited. The judiciaries of these countries, in particular in the Central Asian republics, remain inefficient, corrupt and dependent on the executive.

These recent trips have, however, provided an opportunity to refine the above recommendations, as well as to develop some strategies for the donor community. These strategies can help further legal reform in the countries where the political will for change remains elusive. These refinements are threefold. First, because it is clear that the process is of a long-term nature and because education underlies all other changes, the donor community should make a renewed effort at tackling legal education reform. Second, judicial reform, because it is the key to enforcing new laws, protecting individual as well as economic rights, and counterbalancing the power of the state, must remain a priority. Despite the apparent lack of success, the donor organisations must remain engaged with, and supportive of, judicial reform. Third, advocacy programmes that force the courts to enforce the law and improve access to justice for citizens are proving to be important means of pushing the legal reform agenda.

The longest road: Legal education reform

Legal education reform is clearly the single most important reform undertaking for the region. If law students are not taught how to think critically, question authority, and be guided by law and ethics in their formative years, it is difficult to see how they can be effective and honest advocates, prosecutors and judges when they begin their professional lives.

According to Michael Maya, Director of ABA/CEELI NIS Programmes, legal education reform will face and law schools and the ministries of education are unwilling to tackle legal education reform because they feel it is a long-term problem and programmes will not provide short-term results. This approach, however, is myopic. One of the accepted lessons learned from the past 10 years is that legal reform is a long-term process, requiring long-term strategies. While political will is a problem in some law faculties, such is not the case for all of them. Opportunities – law schools and professors that are open to trying things in a different way – exist in each country. The donor community should be planting the seeds for widespread reform by introducing new ideas and approaches into law schools now, even though they may not reap the benefits for many years to come.

However, there are numerous problems that legal education reform will face and law schools must overcome. First and foremost, there are simply too many schools offering law degrees. According to Michael Maya, Director of ABA/CEELI NIS Programmes, Ukraine increased its law faculties from six in 1990 to over 175 by 1998. Georgia currently has over 200 law faculties, even though its population is 1/10th of Ukraine’s. The United States, by comparison, has fewer than 200 accredited law schools even though its population is roughly 275 million. Maya also highlighted the fact that “many of the new schools being set up are private institutions with no real space, no library, and only a few, part-time professors. Others are affiliated with state institutions that did not previously offer law courses and which are also very small and staffed only part-time. In addition, these faculties have only been established to gain income through tuition fees that new students are willing to pay for a law degree”.

While the increased interest in legal education is gratifying and may ultimately bode well for the development of a law-based society, the quality of the education being offered is clearly a concern. The countries in the region need to develop, with the help of the donor community, stricter accreditation standards that they can then apply fairly and rigorously. Currently, obtaining accreditation in many countries depends more on bribery and on personal connections than on establishing the pedagogical credentials of the institution.

The second significant problem also relates to corruption in professor-student relations. Numerous professors and students have reported that students essentially “pay” their way in and out of the law schools. While it is possible to gain admission and to get good grades based on honest achievement, many students rely on bribery or nepotism. This inculcates a culture of corruption among law students that will be difficult, if not impossible, for them to shed when they become judges, lawyers and prosecutors. In order to defeat this particular scourge universities and the ministries of education will need to improve the working conditions of professors, including raising their salaries and providing for more liberal sabbatical policies. Faculties will need to adopt strict and enforceable ethical codes for their professors, as well as written, perhaps even standardised, admissions and course examinations for the students. These are also areas in which the donor community can lend experience and expertise.

The third issue concerns both course content and teaching methodology. Many classes still emphasise theoretical topics, and are taught almost purely in a lecture format. Many schools still emphasise the ascendancy of the state over
the individual in these courses. However, some important changes have already taken place. Ukraine’s Kharkov State, for example, now offers courses in business law and environmental law. Many schools, particularly in Russia, are offering clinical legal education programmes—an area in which the donor community has provided tremendous support. However, more courses on ethics, human rights and commercial transactions should be offered, with more textbooks being developed for these areas. Again, this is an area where the donor community can be supportive, by funding more Western law professors to co-teach and co-develop books in these universities. In addition, more grants should be provided to law professors from the region to enable them to study and write overseas. More opportunities for teacher exchanges, perhaps through formal links between law schools, would also help to bring the curriculum of these law faculties up to date.7

Judicial reform redux

An independent, accountable and efficient judiciary is necessary for interpreting and enforcing the law, in particular to protect individual civil and property rights as well as legitimate state interests. In many of the countries in the region, however, the judiciaries remain either intimidated, or even controlled, by the executive power.

In Ukraine, despite growing trust in the Constitutional Court and the Supreme Court, most observers believe that if a case involves important political or financial interests, the lower courts will feel obligated to favour the state or the oligarchs. Challenging the executive power, moreover, clearly has risks. In May 2001, for example, the police broke into and searched the chambers of Judge Mykola Zamkovenko, a Kiev judge who had issued decisions adverse to the executive in two politically-charged cases. Another observer added that if a judge acquires a defendant, the judge “will not be re-appointed” to his post the next time. If the judge believes that the defendant is not guilty, the most he can generally do is return the case to the prosecutor’s office for further investigation.8

Judicial corruption remains a tremendous problem, and the visited countries have, as yet, failed to address it in a meaningful fashion. In many countries, for example, court presidents still assign cases to individual judges, and corrupt lawyers, court presidents and judges can conspire to ensure that a case is assigned to the “right” judge. One inexpensive means of assigning cases is by lottery, which can only enhance the credibility of the court system among the public.

Addressing corruption amongst the judiciary also requires that governments prosecute those judges who are suspected of engaging in unethical conduct. It goes without saying that prosecution of judges must be handled very carefully and judicial immunity must be respected. The prosecution of judges, moreover, must be pursued in a fair and transparent manner. In Uzbekistan, a number of judges have been removed from the bench and prosecuted, but the process has not been transparent, and the cases have not been followed in the press. It is therefore difficult to determine whether such removals and prosecutions were warranted or whether they were politically motivated. The party paying the bribe or asserting the pressure also needs to be identified and prosecuted—a process that may touch on even more politically sensitive issues.

The situation is even worse in Uzbekistan. Judges, hamstrung by low salaries (less than police officers) and five-year terms, very rarely make decisions against the interests of the state. The evidence suggests that the procuracy, not the courts, holds the true power to determine issues relating to civil rights and liberties. Verdicts of “not guilty”, for example, are very rare indeed. Three experienced Uzbek lawyers collectively could only remember three times since independence when they had achieved “not guilty” verdicts for their clients. One lawmaker estimated that “not guilty” verdicts are returned “only .0001 per cent of the time.”

As in the Soviet era, the courts simply do not feel sufficiently empowered to counter the will of the state, as embodied by the procuracy. Another observer added that if a judge acquires a defendant, the judge “will not be re-appointed” to his post the next time. If the judge believes that the defendant is not guilty, the most he can generally do is return the case to the prosecutor’s office for further investigation.9


2 Mark Dietrich has conducted additional assessments in the region on legal reform for the World Bank, the United States Agency for International Development (USAID), and the Central and East European Law Initiative of the American Bar Association (ABA/CEELI). The countries visited were Albania, Bosnia and Herzegovina, Bulgaria, Kazakhstan, FYR Macedonia, Romania, Russia, Ukraine and Uzbekistan.


4 Voices Report, p. 16.

5 One could argue that civic and legal education needs to begin at an earlier age, in grade school. Because of the even longer-term nature of that work, as well as the difficulty in tracking results, the donor organisations have been even more hesitant to support such efforts.

6 From original comments by Michael Maya, Director, NIS Programs, ABA/CEELI, at the World Bank Forum on Legal and Judicial Reform in Europe and the former Soviet Union, St. Petersburg, Russia, July 2001.

7 ABA/CEELI, with funding from the United States Information Agency, supported a Sister Law School programme in the mid-1990s that linked American and central European law schools, but most of the partnerships died out when the funding elapsed. Any new partnerships will need to have a stronger basis in shared interests that will extend beyond the funding cycle. The University of Bucharest is one of several schools in the region that have developed sustainable partnerships with Western law faculties, in this case with a consortium of French law schools.

8 One involved the murder of the online journalist Heorhiy Gongadze and the other a corruption charge against Yulia Tymoshenko, a long time critic of the government.

9 State interference with the courts is less of an issue in central Europe. Most of the countries in that region are, for example, shifting the power to issue search and arrest warrants from the prosecutorial bodies to the judiciary. Membership in the Council of Europe and being a signatory to the European Convention on Human Rights have proved to be important catalysts to change, and the European Court for Human Rights in Strasbourg is seeing a large increase in the number of cases filed from the countries in the region.
As already highlighted, the judiciaries in most of these countries remain unreliable and ineffective. The usual donor recipe of developing judicial training centres, supporting judicial associations and providing court administration equipment has not resulted in large-scale improvements. Tinkering with the judiciary of another country involves the donor community into a highly political process. It is understandable therefore that many donors, disillusioned with the results, have moved away from judicial reform programmes, as USAID has done in Kazakhstan, Ukraine and Uzbekistan. 11

Despite the hazards and frustrations, the donor community should be wary of taking an all-or-nothing approach. None of these countries are monolithic, and neither are their judiciaries. Reform leaders in the governments and the courts need to be supported if there is to be hope for reform in the long term. However, where there is no political will, the donor community should not undertake expensive programmes such as computerising the court system or providing extensive overseas training. But it should maintain contact with the judiciary, support training for judges on international human rights standards, and also offer training on commercial issues (which is sometimes more acceptable to the host countries, but which can be used to introduce related concepts on ethics and anti-corruption, for example). The donor organisations should also articulate to the courts and through the mass media why they are not ineffective. The usual donor recipe of developing two means of responding to these environmental infringements, either by government or by private interests. A certain number of cases are selected for filing and litigation in the courts. The caseload has continued to grow. One Lvov EPAC lawyer noted that when they began in 1992 they had five clients per month whereas they now have 60 per month. The EPACs are also winning an increasing number of cases. Several factors have contributed to the success of the EPACs. For example, growing public support for environmental issues has seen the establishment of a good legal framework and the signing of a strong international agreement by Ukraine. Ukraine recently signed the 1998 Aarhus Convention establishing the right to citizen access to information regarding the environment, and this right is emerging as an important tool in environmental litigation in Ukraine.

Furthering societal change through advocacy programmes

As the donor organisations have shifted away from judicial reform in some of these countries, they have begun to emphasise more grassroots and civic education type programmes. USAID has made this shift in both Kazakhstan and Ukraine. More specifically, USAID/Ukraine has supported advocacy programmes that seek to use the law, international treaties and the courts to leverage societal change. These programmes have been generally successful, and may provide a model for donor organisations to pursue in other countries where legal reform has been otherwise stymied.

The Ukrainian environmental movement has developed a strong legal voice through the establishment of Environmental Public Advocacy Centres (EPACs) in Lvov, Kharkov and Kiev, supported by USAID and ABA/CEELI. Each EPAC runs a clinic that reviews complaints from citizens and other organisations related to possible environmental infringements, either by government or by private interests. A certain number of cases are selected for filing and litigation in the courts. The caseload has continued to grow. One Lvov EPAC lawyer noted that when they began in 1992 they had five clients per month whereas they now have 60 per month. The EPACs are also winning an increasing number of cases. Several factors have contributed to the success of the EPACs. For example, growing public support for environmental issues has seen the establishment of a good legal framework and the signing of a strong international agreement by Ukraine. Ukraine recently signed the 1998 Aarhus Convention establishing the right to citizen access to information regarding the environment, and this right is emerging as an important tool in environmental litigation in Ukraine.

Another area where USAID/Ukraine has made an impact through the use of advocacy relates to the media. In Ukraine, journalists, newspapers and TV stations have all been sued for libel and defamation by politicians and oligarchs, with damages being sought at a high enough level to put the media outlet out of business. In 1999, 2,250 such libel cases were filed. With the support of USAID, Ukrainian lawyers and journalists have established the Media Legal Defense Council which provides free representation to journalists and is developing a strong track record. In the 37 cases that have been finalised, the complaint was dismissed in 15 cases, or 40 per cent of the matters. As a result, the media “saved” US$ 5.4 million in damages they did not have to pay. In other cases, the matter was settled out of court, the plaintiff withdrew his complaint, or the judgement for the plaintiff was reversed on appeal and the case was remanded for a new trial. USAID assistance was also instrumental in convincing the Ukrainian Supreme Court to issue guidance that can limit the amount of damages awarded against media outlets.

Obtaining justice for the business community presents a different set of challenges. The difficulties businesses have in surviving the maze of regulations, tax rules and extra legal visits from the myriad inspectors are well documented in Ukraine (and throughout the region). For small- and medium-sized business owners, this has meant paying off one or more of the 34 different taxing, regulatory and licensing agencies capable of putting them out of business. One USAID contractor has developed two means of responding to these problems. The first, the Business Hotline, provides SMEs with emergency advice and a lawyer referral service. The Business Hotline received over 4,000 calls to 24 regional hotlines throughout Ukraine in 2001. The second organised response is called “The Legal Ambulance.” When an SME receives an “unscheduled visit” from a government inspector, usually for the purpose of eliciting a bribe, the businessperson can call the local business association, which dispatches another business leader, a lawyer or other trained person to confront the inspector. More often than not, the inspector departs, unrewarded. The message eventually gets out, and the harassment subsides.
USAID has been working to improve access to justice in Russia through a programme being implemented by the American Center for International Labor Solidarity (ACILS), which supports seven public interest law centres around the country. These centres advise citizens on how to use the courts to obtain salaries and other benefits owed to them by their employers, and support labour activists. The centres have had remarkable success in the courts. In one case, the programme helped a woman labour activist, who had been wrongfully committed to a psychiatric facility, to convince the constitutional court to annul a provision of a criminal procedure code that other courts had used to prevent her from challenging her confinement. The seven centres participate in over 150 cases and provide over 500 consultations per month. In two months, for example, they obtained judgements of US$ 43,888 for back pay and collected US$ 72,792 in judgements. This programme is providing tangible benefits, through the court system, to some of the most needy members of Russian society.

Programmes such as these that promote citizen advocacy are important, and should be replicated, for a number of reasons. First, they are based largely on international standards and treaties, and the host country’s failure to abide by those agreements can bring international condemnation. Second, many of these programmes force change through the judicial system, thereby compelling the courts to do the job they are supposed to do. Linking these programmes with judicial training programmes concerning the international standards at issue can prove especially useful. Lastly, by generating successes and then publicising them, citizen awareness of the law improves. This type of public education is based on the reality of judicial decisions and not on the (often empty) promises of draft legislation.

Conclusion

The three priorities outlined above require renewed attention, but other areas are important as well. The harmonisation and simplification of legislative frameworks remain key and will do much to address the problem of corruption and improve enforcement. Working with the media to ensure better coverage of legal issues, as well as public understanding of the law, is also important. The continuing increase in caseloads of the judiciaries also needs to be addressed.

The foregoing also does not give full credit to the successes that have occurred. The higher courts in Russia and Ukraine are doing more, for example, to make the protections contained in their constitutions a reality for their citizens. More people throughout the region are turning to the courts for the protection of their rights, which is again very good news. Nevertheless, much work still remains. The donor organisations and the host country reformers need to maintain their dialogue in order to ensure that the work is done as efficiently and as quickly as possible. Although developing the rule of law is a long-term process, as one person interviewed for the Voices Report said, “People have a right to justice now.” More than 10 years after the end of the Soviet Union, too many people are still waiting for justice. By addressing the priorities described above, the donors and the reformers can promote change now that will form the future basis for the rule of law throughout the region.

10 In addition, in Kazakhstan, the Government cancelled a World Bank loan that would have targeted judicial reform.

11 ABA/CEELI has developed a checklist of judicial reform measures, entitled “The Judicial Reform Index” (JRI), which is being used to measure progress in this area. The JRI may serve both as a diagnostic tool as well as a means to advocate change. See, e.g., “The Judicial Reform Index for Bosnia and Herzegovina”, The American Bar Association, Washington, DC, (2002). The JRI is also being applied in Armenia, Bulgaria, Croatia, FR Yugoslavia (Serbia), FYR Macedonia, Romania, Ukraine and Uzbekistan.

* Mark K. Dietrich
21 East 90th Street
New York, NY 10128
Tel: 917 498 8502
Email: mdietrich@email.msn.com
or alternatively on mdietrich@hotmail.com

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Legal developments

Insurance law
On 29 March 2002 parliament approved a new law on Insurance of (Bank) Deposits. The new law provides for the establishment of the Supervising Authority and of the Agency for Insurance of Deposits. The Agency is in charge of compensating loss of insured deposits (at various degrees based on threshold amounts), administrating its own funds and cooperating with the Supervising Authority and foreign bodies of similar character. The law will enter into force later this year.

Securities registration
On 12 February 2002 the Securities Committee of the Council of Ministers adopted a Regulation on the Issuance and Registration of Securities on the Territory of Belarus. The regulation governs the procedures for issuing and registering shares of joint stock companies in a wide variety of circumstances, including at the stage of company formation, charter capital increases and in connection with corporate reorganisations. It also regulates the issuance and registration of bonds and provides the much-needed detail to the law governing corporate finance.

Derivatives legislation
On 4 February 2002 the Securities Committee of the Council of Ministers adopted a Regulation on Derivatives. The regulation relates only to options and futures contracts and does not provide a comprehensive regulatory framework for dealings in derivatives. It gives short definitions of terms for options and futures contracts as well as of the generic concept of a derivative. Despite its limited scope the regulation is important because it fills significant gaps in the existing law and provides a basis for further regulation in this area.

Banking legislation
In a decree dated 31 January 2002 the Management of the National Bank of Belarus adopted Rules for the Conduct by Banks in Belarus of Operations involving the Use of Promissory Notes and Bills of Exchange. The rules govern such matters as the form and issuance of notes by commercial banks, terms for dealing in notes on secondary markets, lending of notes, use of notes by way of security, operations with foreign promissory notes, acceptance of bills and novation and exchange of bills and notes. The rules are comprehensive and provide much-needed guidance in this field.

Secured transactions
At the end of April 2001, the Federation of Bosnia and Herzegovina adopted a new Law on Registered Pledges and the Pledge Registry. A Law on Registered Pledges on Movable and Shares was adopted in the Republika Srpska and in the District of Brčko in 2000. Lack of funding and other difficulties, however, slowed progress in implementation and none of these laws are actually in force or operating. The Federation’s draft law is similar to a large extent to these other laws.

Telecommunications policy
On 28 March 2002 an updated telecommunications policy was adopted by the Council of Ministers. Among the actions that are defined in the policy are a new legal framework and the issuance of the third Global System for Mobile (GSM) licence. With regard to privatisation, the policy foresees an advisory group to be established by the Entity governments in order to prepare the necessary political decisions. Based on the new policy the Communications Regulatory Agency issued a number of licences to network operators and general authorisations to Internet Service Providers on 11 April 2002. The licences for the fixed line operators are being finalised and are expected to be issued shortly. This will fulfill an essential prerequisite of future privatisation and, at the same time, guarantee the introduction of competition in the fixed sector network.

Stock exchange market
In March 2002 the first stock exchange opened in Banja Luka. In April 2002, a second stock exchange opened in Sarajevo. The Sarajevo Stock Exchange, which is an online market, will offer shares in 120 companies worth some €45.3 million.
Energy sector
On 21 March 2002 parliament passed a Law on Electricity Transmission, Regulator and System Operator that forms the legal basis for the establishment of a single electricity market in the country and an institutional structure at the state level. The new law establishes: (i) a state regulatory commission for electricity transmission; (ii) an independent system operator; and (iii) a transmission company. It is now the responsibility of the Entities’ parliaments to nominate the three Commissioners of the regulatory commission who will finally be appointed by the Parliament of Bosnia and Herzegovina. The Entities’ electricity laws are currently being reviewed by experts and are expected to be adopted shortly.

Bulgaria
Legal developments
Financial services
According to an initiative of the Cabinet of Ministers in early 2002, the Government is planning to establish a single supervisory body for the financial sector. The Bulgarian National Bank, the Agency on Insurance Supervision, the State Agency on Social Security Supervision and the State Securities Commission have already agreed to be merged into the new agency. The new agency is expected to have consultative powers and to include representatives of the Cabinet of Ministers and parliament as observers.

Taxation law
On 1 January 2002 amendments to the Corporate Income Taxation Law took effect. The main change relates to the reduction in the tax on profits from 20 per cent to 15 per cent, which applies to all tax liable persons regardless of their taxable turnover. Profits from direct economic activity of local or foreign entities operating through a Bulgarian branch or another permanent establishment in Bulgaria are taxed at the rate of 23.5 per cent (10 per cent municipal tax, followed by 15 per cent state tax on profits minus paid municipal tax). Non-resident taxpayers are taxed on their Bulgarian-source income while resident taxpayers are taxed on their worldwide income.

Czech Republic
Legal developments
Environmental legislation
Amendments to the Criminal Code, which took effect in July 2002, increase the potential for environmental pollution and other damage to be considered a crime. Environmental damage that is long lasting or permanent will be subject to prison sentences of one to five years, while endangering rare fauna or flora could result in a year’s imprisonment. The law, which aims to bring the Criminal Code into line with European Union requirements, also bolsters the fight against economic crime. Hiding the origin of stolen goods, for example, will now be subject to a criminal penalty of up to two years imprisonment.

Pledge law amendments
On 1 January 2002 various amendments to the Civil Code, Notarial Code and Civil Procedure Code entered into force. According to such amendments it is possible to pledge an enterprise as the aggregate of tangible, personal and intangible assets constituting a business activity (as well as any other collective asset). In addition, the Civil Code will now allow for the pledge of other objects and property rights, including movables, immovables, receivables, certain apartments and non-residential premises, participation interests in limited liability companies, securities and objects of industrial ownership. The effectiveness of any such pledges shall be subject to registration with a newly-created electronic Register of Pledges that will be maintained by the Notarial Chamber.

Estonia
Legal developments
Civil Code
On 27 March 2002 parliament adopted the General Part of the Civil Code, which is instrumental in completing civil law reform in the country, and which includes procedures for contesting disputes arising out of transactions. Other included amendments cover legal capacity, residence, legal entity, good faith, intention and limitations. The new provisions will substantially affect existing contractual relationships.

FR Yugoslavia
Legal developments
Constitutional law
FR Yugoslavia’s federal framework will be substantially reshaped following a historic deal between the Republic of Serbia and the Republic of Montenegro signed on 14 March 2002. According to the agreement both constituent republics will become semi-independent states with their own economies, currencies and customs frameworks. Federal institutions will be preserved only in the spheres of presidency, defence and foreign affairs. The agreement, which must gain the approval of both Serbian and Montenegrin parliaments, allows for the possibility of the Republic of Montenegro seeking full independence in the future.

Legal reform project
Telecommunications regulatory reform
The EBRD is currently developing a project to assist in establishing a clear and predictable telecommunications regulatory framework likely to attract private investment and to enable the overall development of the sector. The project will have as its objectives: (i) the elaboration of a sector policy for telecommunications together with policies for licensing, interconnection and tariffs; (ii) the adoption of a modern telecommunications law; (iii) the establishment of an independent regulatory authority; and (iv) the improvement of general awareness of telecommunications law and policy.

FYR Macedonia
Legal developments
Pension funds
In April 2002 parliament adopted the Law on Obligatory Capital Financed Pension Insurance. The law serves as the legal basis for the second pillar of the pension system and was approved following numerous public discussions and roundtables organised by the institutions involved. From 1 January 2003 capital financed pension insurance will be obligatory for all newly employed persons, although the system will not become fully operational until 1 January 2004. The law also envisages the creation of a state agency for capital financed pension insurance supervision.

Leasing
In early 2002 a new Leasing Law was adopted by parliament. The new legislation is expected to provide the legal underpinning necessary for the development of leasing as a commercial activity in the country.

Georgia
Legal reform projects
Telecommunications regulatory reform
In June 2002 the EBRD completed an extension to the Telecommunications Regulatory Development Programme. This extension involved the delivery of a tariff/revenue model to the governmental authorities and the provision of training in the use of the model. This project was funded by the European Union.
Legal developments

Capital markets

On 1 January 2002 a new Law on Capital Markets replaced the Securities Law of 1996, the Commodities Exchange Law of 1994 and the Investment Funds Law of 1991. The new consolidated law was designed to bring regulation of various capital market activities under one body, the Hungarian Financial Supervisory Authority, and to establish common rules for the various service providers regarding such matters as conflicts of interest, advertising and confidentiality. The law liberalises certain capital markets activities but also increases investor protection through increased capital requirements and disclosure and reporting obligations. The law is also intended to harmonise Hungarian law in this area with the relevant EU directives.

Telecommunications

On 23 December 2001 a new Law on Telecommunications came into effect facilitating greater liberalisation of the market for telecommunication services. The new legislation has brought Hungary in line with EU norms with respect to liberalisation of fixed telephony services. The new law provides for government control over the price of basic fixed-line services, including the internet. The new law also ended the incumbent operator’s (Matav) monopoly on long-distance and international fixed-line services and its monopoly concession to a large part of the local loop. Provisions relating to Significant Market Players (SMPs) – above 25 per cent share of market – in the fixed-line, cellular or leased-line markets are also brought into play. Matav is automatically given the status of an SMP. SMPs are bound by the new law to inform fellow market providers of the specifications needed for interconnection and unbundling; are forbidden from discrimination in access to their networks; and are to provide identical terms of access to all players holding interconnection and unbundling contracts. With respect to universal service, the new law requires telecom providers to provide basic telecom services, including access to the fixed-line network, including faxes and data provision. If firms are making a loss as a result of the provision of basic services, they will be compensated from a fund, funded by charges on operators.

Kazakhstan

Legal developments

Investment law

On 21 June 2002 parliament passed a new Law on Investments. The new law grants domestic investors the same privileges as their foreign counterparts, while assuring foreign investors that old contracts will not be retroactively affected. The law provides domestic investors with guarantees should nationalisation, expropriation or illegal actions of civil servants occur. The new law also allows foreign investors, who came into the country before the law was passed, to continue using tax preferences for the next 10 years. In addition, for the first time, it enables both local and foreign investors to seek justice in international arbitration if so agreed by the parties.

Railroad law

On 8 December 2001 the Law on Railroad Transport was adopted, setting forth various regulations for the legal relations between carriers, passengers, consignors, railroad companies, state agencies, physical and legal entities when transporting passengers and their luggage, cargo and mail by railroad. The Railroad Law is part of the creation of the first unified set of rules governing the different aspects of railroad operations following the total restructuring of the industry in Kazakhstan. It provides for the exclusive state ownership of main railroad lines i.e., those routes which connect the different regions of Kazakhstan and international routes, whereas other lines can be privately owned. The Railroad Law delineates in great detail the powers of the state agencies in regulating railroad transport, labour and technical safety issues, as well as obligatory insurance for passengers.

Procurement law

On 16 May 2002 a new Law on State Procurement came into effect, replacing the previous law dated 16 July 1997. The law is intended among other things to encourage competition, improve cost efficiency and make the public procurement process more transparent. It covers the procurement of goods, works and services by state agencies, state enterprises, joint-stock companies in which the state is the controlling shareholder and their affiliated legal entities.

Kyrgyz Republic

Legal developments

Production sharing agreements

On 11 April 2002 the President signed the Law on Production Sharing during Exploitation of Mineral Wealth, which was adopted by the Legislative Assembly of the Kyrgyz parliament. The law establishes the legal basis for relations arising when both Kyrgyz and foreign investments are used to fund surveying, exploration and development of raw material resources in the territory of the Kyrgyz Republic, and sets out the conditions for production sharing agreements.

Latvia

Legal developments

Competition law

On 1 January 2002 a new Competition Law came into force. The law aims to harmonise Latvian legislation in this area with EU requirements in the framework of Latvia’s efforts to join the EU.

Lithuania

Legal developments

Civil Procedure Code

In February 2002 Lithuania adopted a new Code of Civil Procedure that will enter into force in January 2003. The new Code, which provides for procedures consistent with the Civil Code already in force, generally aims at ensuring prompt hearing of the cases by the courts and conscientious conduct of the parties throughout the process.

Securities

A new Law on Public Trading in Securities was adopted in December 2001 and became effective in April 2002. This new law aims at harmonising the Lithuanian securities regulations with EU standards and the new Civil Code. Among the key changes, the law provides for a mandatory public take-over offer in the event that a party (or parties acting together) acquires more than 40 per cent of the shares of a listed company (instead of 50 per cent previously).

Money laundering

In March 2002 Lithuania adopted the Law on Prevention of Money Laundering, which became effective the following month. The new law provides for stricter disclosure and reporting requirements on credit and financial institutions in respect of transactions carried out by their clients. Its implementation is under the responsibility of the State Insurance Supervision Authority and the Securities Commission.
Moldova

Legal developments

Civil Code

In April 2002 a new Civil Code, which replaces the 1964 Soviet-era Code, was passed. It aims to provide a firmer legal basis for property and contract enforcement. However, the version passed by parliament has been criticised by judges and other legal experts for differing considerably from the version on which they were consulted. These shortcomings are further highlighted by the fact that one of the conditions for resumption of the suspended IMF financing is the revision of the recently-adopted Civil Code to make it more compliant with international standards and with the principles of a market economy.

Russian Federation

Legal developments

Code of Administrative Offences

A new Code of Administrative Offences took effect on 1 July 2002. The Code brings together all penalties for various types of administrative offences previously covered by various laws. It replaces legislation that dates back to 1984. Some of the provisions of the new Code of Administrative Offences are applicable exclusively to individuals, while other articles that apply to companies have been included for the first time. It also covers penalties for breach of environmental law, consumer protection law, anti-monopoly law, advertising law, customs and tax law, work safety regulations and intellectual property law. Penalties vary from fines to disqualification from business activity. However, the low level of fines imposed on companies and individuals for infringement may undermine the practical effect of the Code.

Legal reform projects

Telecommunications regulatory reform

The EBRD will shortly begin to implement the second stage of a telecommunications regulatory reform project aimed at assisting the Russian authorities to develop a modern regulatory framework. This project will address the priority areas of universal service, licensing and interconnection. The project is being funded by the US government.

Slovak Republic

Legal developments

Labour Code

On 1 April 2002 the new Labour Code came into effect. Compared with an earlier draft of the law, there is no general obligation on employers to arrange a new job for a dismissed employee, no need to pay for unused holidays and no obligatory financial subsidy for catering. However, the new Labour Code continues to prohibit the employment of women for certain jobs.

Telecommunications

In June 2002 an amendment to the Telecommunications Law, aimed at implementing EU Directives for the telecommunications industry, was passed by the parliament. The amendment covers a number of EU directives, most importantly local loop unbundling (LLU), which will enable competition to spread in the market for high-speed data transmission services. Aside from LLU, the amendment will also increase the powers of the regulator, the Telecommunications Office, and change its licensing regime, enabling it to play a more active role in negotiations or contracts between parties, together with enhancing its cooperation with the Anti-Monopoly Office and broadcast regulator. The amendment is scheduled to take effect in January 2003 and will bring Slovak law into line with EU requirements, in addition to boosting competition and removing various shortcomings in the existing legislation.

Payments and settlements

In March 2002 the National Bank of the Slovak Republic approved a draft Law on Payments and Settlements, aiming to bring Slovak legislation on the subject into line with EU requirements. The law, if adopted as planned, is expected to come into effect on 1 January 2003, with the exception of some parts that will only take effect when the Slovak Republic joins the EU. The draft law imposes stricter regulations for domestic and foreign money transfers, electronic payment final settlement and clearer procedures for claims.

Draft stock exchange legislation

In April 2002 the Slovak Government approved draft comprehensive legislation concerning the Slovak stock exchanges. The new legislation, if adopted by parliament, is expected to provide much greater protection for investors. It also aims to bring Slovak stock exchange legislation into line with EU requirements and covers the creation, status and activity of stock exchanges, and procedures for the launch and trading of share offerings and other financial instruments.

Tajikistan

Legal developments

Telecommunications

In April 2002 a new Law on Telecommunications was passed by parliament that introduces market principles in the telecommunications sector. The law is aimed at attracting private investment and enabling the overall development of the telecommunications sector. It establishes a legal and regulatory framework by setting out the authority and functions of the various government agencies that deal with telecommunications matters. In addition, the law regulates other key areas such as licensing and certification of telecommunication services and service providers, tariffs, interconnection and network access arrangements, monopolistic and anti-competitive behaviour. The EBRD provided assistance with respect to drafting of the law with funding support provided by Japan.

Legal reform projects

Telecommunications reform – Phase II

The EBRD has launched phase II of the Tajikistan Telecommunications Regulatory Development Programme. Following on from phase I of the programme, phase II will assist the Tajik authorities in further improving and implementing initiatives related to telecommunications policy, interconnection, licensing and universal service. Japan is funding the project.
Legal developments

Banking law

In November 2001 and January 2002, National Bank of Ukraine Regulations came into effect which set the procedures for establishment and registration of banks, including banks with foreign capital, affiliates, representative offices and branches, bank corporations and bank holding groups.

Competition law

In March 2002 the Law on Protection Against Economic Competition entered into effect. The law defines and sets forth the principal features of anti-competitive concerted actions, abuse of a monopolistic (dominant) position and restrictive and discriminatory activities by businesses and their associations.

Uzbekistan

Legal developments

Production sharing agreements

On 7 December 2001 parliament passed a Law on Production Sharing Agreements. Following the new law, foreign investors can obtain exclusive rights to explore and produce mineral resources in Uzbekistan by entering into a production sharing agreement. The new law guarantees foreign investors the right to export their portion of subsoil resources, grants tax exemptions, provides comfort against future adverse legislative changes and contains various other provisions standard for production sharing agreements legislation in other CIS countries.
Meeting of the Pro-Bono Committee on Joint Ventures Model Contracts for Small and Medium Enterprises (SMEs), International Trade Centre (ITC), Geneva

On 10 January 2002, the first meeting of the Pro-Bono Committee on Joint Ventures Model Contracts for SMEs, launched by the ITC, an international organisation affiliated both to the United Nations and to the World Trade Organization, was held in Geneva, Switzerland. This meeting was held in the framework of ITC’s initiative to develop model joint venture agreements and guides for their use. This initiative was undertaken following the demand for such agreements from the international business community, in particular in developing countries and economies in transition. The first meeting was attended by approximately 30 international participants, including an EBRD representative. The Committee comprised lawyers working in private practice and private sector enterprises as well as lawyers working for international organisations, such as the African Development Bank, the Union Economique et Monétaire Ouest-Africaine and the Asian Development Bank. The meeting discussed the various options for drafting model contracts and the future activities of the Committee to carry forward the work.

Meeting of International Financial Institutions and the European Commission on regulation and international cooperation in electronic communications policy, Brussels

On 18 February 2002, as part of ongoing international cooperation among global and regional development institutions, the EBRD participated in a meeting of international financial institutions in Brussels, Belgium. The meeting was hosted by the European Commission Information Society Directorate-General and brought together representatives of the European Commission, the World Bank, the International Finance Corporation, the European Investment Bank and the EBRD. The meeting presented the opportunity for the institutions to update each other on their respective projects and operations in the area of electronic communications, review cooperation to date and identify appropriate areas for future collaboration.


On 20-22 March 2002 an international colloquium on the preparation of a Legislative Guide on Secured Transactions organised by the UNCITRAL secretariat in association with the Commercial Finance Association took place in Vienna, Austria. The Guide will focus primarily on the security of goods, but also intangible assets. The Colloquium gave participants an opportunity to discuss the first preliminary draft Guide prepared by the UNCITRAL secretariat with expert assistance and to present proposals to the Working Group that subsequently met in New York, on 20-24 May 2002. The Working Group meeting reviewed the first five chapters of the draft and proposed recommendations. The work will be taken forward in the next meeting planned for December 2002 in Vienna.

Public Private Partnership Alliance (PPP), Geneva

In March 2002 the EBRD attended the Public Private Partnership Alliance launch meeting in Geneva sponsored by the United Nations Economic Commission for Europe. During the meeting the Alliance agreed to form several working groups to identify what assistance can be provided to individual countries and/or their PPP units. The PPP unit of the Ministry of Finance of the Netherlands hosted the first Legal Working Group meeting on 28 June 2002. The Working Group discussed its short-term plans and ways of bringing additional sources of investment, including private sector finance, to governmental and municipal projects in transition economies.

OECD Third Eurasia Corporate Governance Roundtable, Kiev

On 17-18 April 2001 the Organisation for Economic Co-operation and Development (OECD) organised the Third Eurasia Corporate Governance Roundtable in Kiev, Ukraine. The third roundtable was a well-attended event bringing together representatives from the region’s businesses, international financial institutions and academics. It focused on shareholders’ rights and equitable treatment of shareholders. The issues discussed included incentives for good corporate governance, the need for an effective legal framework, the role of the state as a shareholder and the protection of minority shareholders. EBRD Counsel Hsianmin Chen made an intervention at the last session of the roundtable, reporting the preliminary results of the Corporate Governance Sector Assessment project undertaken by the EBRD.

Conference on Regulatory Governance and Network Industries, Sarajevo

On 19 April 2002 a joint conference hosted by the Organisation for Economic Co-operation and Development (OECD) and the Office of the High Representative (OHR) took place in Sarajevo, Bosnia and Herzegovina. The conference was designed for ministers and officials at both state and entity levels in Bosnia and Herzegovina and dealt with cross sector regulatory governance (telecommunications, energy, transport, etc.). Conference speakers included representatives from the OHR, the International Energy Agency, OECD, the European Commission and the Government of Greece. The conference attracted high-level participation, including the Chairman of the Council of Ministers of Bosnia and Herzegovina, state and entity level Ministers and officials, together with representatives
of the international community. The EBRD has been active in regulatory reform in Bosnia and Herzegovina for several years, assisting the authorities in implementing a modern telecommunications regulatory framework that will facilitate the development of the telecommunications sector. EBRD Counsel Paul Moffatt presented the Bank’s policy and regulation in the telecommunications sector setting out its experiences of regulatory reform. He also took part in a panel discussion on economic regulation of network industries.

World Bank/International Monetary Fund Banking Insolvency Initiative, Warsaw

On 22-24 April 2002 in Warsaw, Poland, the National Bank of Poland hosted a Joint Seminar on Comparative Experiences in Confronting Banking Sector Problems in central and eastern Europe and Central Asia. The seminar, sponsored by the World Bank, the IMF and the EBRD, was part of an initiative to fill a significant gap in the measures taken to strengthen banking systems. While there is a good deal of international uniformity in the area of law governing the legal status, organisation and operations of banks as well as the enforcement of prudential regulation, there is less agreement regarding regulatory corrective action, bank receivership and bank insolvency.

EBRD General Counsel Emmanuel Maurice opened the three-day seminar. During the seminar delegates attended lectures on the experiences, both within and outside the region, of dealing with difficulties in banking systems. The aim was to share the lessons learned and begin to formulate international standards or guidelines to address the issues raised by bank insolvencies.

UNCITRAL Session on Insolvency, New York

From 13-17 May 2002 UNCITRAL held the twenty-sixth session of the Working Group at the UN Headquarters, in New York, USA, to discuss a detailed and comprehensive Legislative Guide on Insolvency Law being prepared by UNCITRAL. The purpose of the Guide is to assist in developing efficient and effective legal frameworks for insolvency. The Working Group has been as specific as possible in developing its work, in order to ensure that the Guide provides the required guidance. To that end, the Guide will include model legislative provisions addressing some of the issues.

UNCITRAL has enlisted the help of a number of external organisations, including the EBRD, as well as academics and experts on international insolvency law to comment on proposed drafts.

OECD Second Roundtable on Corporate Governance in south-eastern Europe, Istanbul

On 30-31 May 2002, the OECD organised the second south-eastern Europe Corporate Governance Roundtable in Istanbul, Turkey. The OECD Centre for Private Sector Development and the Turkish International Co-operation Agency hosted the meeting. The roundtable brought together experts and professionals of private and public sectors from the countries of south-eastern Europe, including chairmen of securities commissions and heads of national stock exchanges. While the roundtable served as a forum for sharing national experiences and discussing ways of adapting remedies adopted in OECD countries, the discussions centred on issues concerning transparency and disclosure. The EBRD’s Director of the Equity Support Unit, Lindsay Forbes, chaired a session focusing on non-financial disclosure issues.

UNCITRAL Model Law on Privately Financed Infrastructure Projects, Vienna

In January and June 2002, expert group meetings were held in Vienna, Austria, to discuss the Legislative Guide on Privately Financed Infrastructure Projects following its adoption in 2000. The expert group, including a representative of the EBRD, is working on model legislative provisions and expects to submit a draft text for consideration by the UNCITRAL Working Group at its fifth session in Vienna on 9-13 September 2002. It is expected that the model law and legislative provisions will assist those countries in the process of drafting or reforming their concession related legislation.

East-West Management Institute, Partners for Financial Stability (PFS) Programme Symposium on Registered Pledge Systems in Six Transition Economies, Gdansk

On 4 June 2002 the PFS Programme, in cooperation with the Gdansk Institute for Market Economics, conducted a Regional Symposium on Registered Pledge Systems in Six Transition Economies in Gdansk, Poland. Participants from 10 countries attended the symposium, which presented some of the findings of country studies on the economic impact of registered pledge systems co-financed by the PFS Programme. Presentations covered studies in Albania, Bulgaria, the Czech Republic, Hungary, Lithuania and Poland. The symposium acted as a forum for discussion on the EBRD/PFS Programme co-financed study “Experiences and Attitudes Among Participants in the Secured Transactions System: Hungary 2002”. EBRD counsel Frederique Dahan presented the keynote speech to the symposium on the EBRD’s Secured Transactions Project.