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# Markets in Transition: Reconstruction and Development: Introduction

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## **Markets in Transition: Reconstruction and Development**

### **Introduction**

*Elizabeth Rindskopf Parker\**

This important symposium introduces topics too little considered in legal academic circles but vital to today's world: how do nations move from command to market economies? In two days of discussion, a series of experts first look at several developing countries: China, Russia, Kosovo, Cape Verde, and Iraq and then at the most important means by which emerging economies advance: privatization and project finance. Lawyers and their clients, as well as the world community as a whole, have much to learn from these discussions: the 24th Annual International Symposium of the University of the Pacific, McGeorge School of Law.

Sarah Carey, Yukos Oil Company Board member and Squire, Sanders & Dempsey partner, begins the discussion by focusing on Russia. While optimistic about Russia's "Big Bang" approach to modernization, Carey admits that problems remain in creating a modern legal and economic system. Russia lacks an independent judiciary and an internalized understanding of recently adopted western laws and its regulatory structure is too modest to control new post Cold War commercial giants such as Yukos. The current challenge of the Russian government to the Yukos giant reflects fundamental changes within the society. Unfortunately Russia is not well situated to move to a market economy. Carey explains that Russia, unlike China, not only lacks the legal structures needed to support a commercial base but also lacks arable land which might provide an agriculture base on which to rest a more gradual approach. Thus, Russia's "Big Bang" approach may have been preordained. Whatever the explanation, in Russia's approach to modernization Carey finds a universal lesson: "Western consultants advising without awareness of the local context do more harm than good."

China offers an interesting comparison. Professors Frank Wang and Laura Young use traditional Chinese property law to highlight the historic difficulties China has experienced in borrowing from Western legal and philosophical traditions. They explain how in grafting German law onto an ancient and well-developed Chinese legal system and in later applying European Communism to eliminate traditional Chinese rights of property ownership, traditional sources of Chinese law have been obscured. The Wang/Young team shows how China's recent efforts to create a market economy demonstrate promise in reversing this process.

The deliberate Chinese approach exists in sharp contrast to the Russian "Big Bang." Unlike Russia, the Chinese Communist Party has retained its power and the resulting political stability provides the confidence necessary to support economic

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progress. Still, as in any developing country, rapidly adopted western laws, rules and regulations must adapt to the local cultural context. Fortunately the Chinese tradition includes a role for lawyers and law sympathetic to modern norms. The Wang/Young comments explain why the Chinese government has recognized the need for lawyers and encouraged their education by building law schools. In their experience, China in the twenty-first century appears to have relearned the lesson that economic success needs rules, credibly enforced. Now the challenge is to insure that rules and culture reinforce one another.

Professor Edwin Villmoare's work in Eastern Europe provides the context to consider the three stages required to develop a rule of law system: statute drafting, ratification of rules and constitutions by the government and creation of a judicial system. Noting that often those who do this work are actually volunteers from other cultures, Villmoare observes that such efforts often reflect little connection between a nation's economic development and its present capacity for nation-building. Further, external forces under U.N. leadership may impose requirements without adequate "buy-in" from local populations. Such disjunctures between new legal systems and the perceived needs of their traumatized populations are not easily solved. Villmoare concludes that a true rule of law environment will require generations to achieve in Eastern Europe.

Professor Marjorie Florestal sounds a brighter note in her assessment of Cape Verde, a small nation seeking World Trade Organisation ("WTO") accession. With a dramatically improved literacy rate, rising annual income, evolving service economy centered on tourism and banking, and a lack of corruption, Cape Verde has much to celebrate. Still, as Florestal notes, the new WTO standards may create their own version of economic "shock therapy," with unpredictable results. Only time will tell, but this small nation is one worth watching.

Turning to Iraq, Professor Antonio Perez argues that international law, despite good intentions by the United States, may impose limits on available reconstruction options. The U.S. objective, "the creation of the democratic and market-oriented regime changing [regional] geopolitics," is incompatible with international law requirements for occupying forces. Perez concludes that U.S. policy makers may have erred in assuming that a unilateral post-war occupation could fully transform the Iraqi government and political system. In short, without U.N. authorization, underlying legal ambiguities may exist which will produce disincentives for the commercial players who are essential for reform of Iraq's economic and political system.

In contrast, Bart Fisher, cofounder of the U.S. Iraq Business Council, answers Professor Perez's question "What is to become of Iraq?" more optimistically because U.N. Resolution 1483 authorizes the provisional U.S. authorities to create investment-friendly regimes and a helpful banking structure with which to attract foreign capital to Iraq. Still, Fisher agrees that the United States will need the United Nations and its allies to achieve effective regime-change. Their increasing unwillingness to participate presages a negative outcome.

The Symposium's second day considers two important tools which can help formerly command economies in their transition to market economies: project finance and privatization.

Professor Don Wallace, Georgetown University, begins with fundamental questions: Can law reform and law harmonization create a single international vision appropriate for all countries? Is a host country legal framework necessary and if so, what must that framework include? Governments by themselves are inadequate to meet the financial support demands of infrastructure development and so Wallace argues that private sector involvement is inevitable. As a financing technique, project finance is the only way to mobilize sufficient capital. Unfortunately, too many developing countries lack experience in policy development or practical negotiation to take advantage of private capital. As a result, these countries lack the capacity to engage in project finance opportunities effectively or to ensure a fair balance of interests involved because they lack the legal framework and regulations needed to support such projects. Such lack of experience and training in host countries is a major difficulty, often further complicated by ideological resistance to using market-based approaches to infrastructure development.

Kenneth Hansen of Chadbourne and Parke explains the origins of the Marshall Plan, which provides the operational basis for modern players, such as the Overseas Private Investment Corporation ("OPIC") and the U.S. Export/Import Bank ("ExIm"). Approaches to political risk insurance by OPIC and ExIm in troubled areas of the world continue to evolve, but offer a success story which has enabled the private sector to stimulate growth worldwide in emerging market economies. Geoffrey Anderson, OPIC Deputy General Counsel, explains how this U.S.-backed agency provides long-term financing, political risk insurance, and investment funds focused on infrastructure and technology.

The success of project finance has created an ever growing demand for funding. Jim Croke of Cadwalader, Wickersham and Taft discusses how innovative securitization techniques can address the increasing demand for project finance funding. His discussion of private placement "project bonds" by institutional investors suggests an approach potentially more favorable than traditional bank funded project debt. Croke's description of new approaches to project finance challenges developing nations to support securitization by updating their regulatory structures. Alfredo Pascual, Director of Private Sector Operations, Asian Development Bank, which supports both public and private sectors in Asia, contrasts with Latin America. Unlike Latin America, "starting afresh" has been possible in Asia and offers an advantage over having to reconfigure existing infrastructure capacity. Pascual draws important lessons from the 1997 Asian financial crisis and offers a road map of "best practices for successful infrastructure development in emerging economies."

Representing the International Finance Corporation ("IFC") of the International Bank for Reconstruction and Development ("World Bank"), Principal Counsel Carol Mates explains IFC's role in supporting private sector development in both state sponsored projects and independent, private infrastructure projects. IFC recognizes that a deep and continuing suspicion of capitalism exists in many emerging markets.

Thus, no IFC investment is free of political considerations and there has been an increasing focus on sound environment and social policies, as well as modern legal system. IFC's goal is to persuade host countries to give preferred status to multilateral lenders, to enable them to support emerging economies, even during challenging periods.

Katharine Baragona, Vice President of the Asset Finance Group, Citibank, introduces the private sector lender perspective with a step-by-step analysis of the components of a successful project finance agreement. Finally, Professor Michael P. Malloy offers a thoughtful explanation of the relationship between successful international development policy and bank regulatory policy. Defining project finance as a "method of funding in which the lender looks primarily to the revenues generated by a single project both as the source of repayment and security for the loan," he concludes project finance is the preferred approach to development in emerging economies, replacing traditional governmental support. Still, the private sector's dominant role in funding major infrastructure projects increases the importance of international legal investment regimes. Malloy clarifies the detailed structure underlying this international framework, noting both the Basel Committee's efforts to amend its 1988 guidelines to create a harmonized system for globalized financial practices and significant changes in the regulatory framework of the Bank for International Settlements ("BIS"). An important forum for regulatory policy development, BIS is revising its capital adequacy rules, with direct impact on risk management considerations central to project finance lending decisions. Malloy offers a comprehensive look at these changes—a topic important for those active in project finance.

In his luncheon address, Martin Kamarck, former director of the United States Export-Import Bank, and now a principal at Radian Asset Insurance, Inc., shows that the need for infrastructure development far surpasses current sources of governmental and bank funding. Kamarck's solution to this problem is use of the global fixed income markets. They are the only source of funding adequate to address the infrastructure needs of developing nations and the only way that the international community can meet the overarching purpose of "promoting economic development for world betterment." Contrary to popular opinion, Kamarck argues that bond investors do not exacerbate bubble economy problems as was seen recently in the Asian development crisis. In fact, bond markets, unlike bank lending, move gradually in their investment and withdrawal cycles, actually providing protection against the more rapid responses of bank lenders.

In concluding remarks, Professors Lucien Dhooge and Stephen McCaffrey emphasize the need to ensure basic human rights as the only way possible to achieve the political stability most conducive to project finance.