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Compensation – Formula with Boomerang Effect

The Western markets can absorb only limited quantities of East European goods and East Europe is incapable of supplying sufficient quantities of products marketable in the West. Therefore it is feared lest the expansion of trade between West Germany and the East, from 1974 onwards, should lead into a *cul-de-sac*. For this reason, it is not surprising that the business world, the politicians, and economic research turned their attention to the problem of East Europe's indebtedness. This discussion has scarcely been able to provide clear answers to the question of the indebtedness margins of the debtors in the East and the credit margins for the creditors in the West. But through this discussion the total volume of the credits raised by East Europe in the West has become known, at least in their approximate entirety. This enabled the computing of the overall volume of financial funds needed in the future for trading with East Europe when all the brakes on it were released – a trade which would, for its overwhelming part, flow in one direction only. West Germany alone, which, up to now, has supplied about one quarter of all the credits granted to the East, would then have to finance, up to 1980, an overall volume of credits ranging approximately between DM 60 to 80 bn, should its exports to the East continue to grow at the present rate.

However, statistically, 1975 has already been a year of a less hectic trade expansion because at least the smaller and economically weaker CMEA-countries have managed to pull in the reins of their imports from the West. During 1976, the import/export trends of the preceding years were reversed: West German exports to Eastern Europe virtually stagnated, whilst imports from Eastern Europe rose by about 27 p.c.

Will it now be possible to draw the much farther-reaching inference that Eastern Europe, for achieving its ambitious growth and structural aims, would not, in the future, need so many Western import supplies, or that it had recently come to the decision to think over afresh its aims, with a view to cutting them down significantly? This double question can only be answered with a clear No. Admittedly, the developments in East/Western trade during 1975/76 indicate its arrival at a kind of turning point, but there are also many indications that East Europe is engaged in a supreme effort to open up new avenues along which the exchange of goods could be further expanded more or less without a break. In the forefront of all the countries of East Europe, the Soviet Union proclaims that a favourable development might be expected on the foundation of compensation exchanges that would be of advantages to all sides. Thus, Patolichev, Soviet Minister for Foreign Trade, has emphasized unambiguously that the Soviet Union, for financial reasons, is compelled to arrange increasingly counterpart transactions for its purchases in the West. The German Democratic Republic, in its turn, has used its Leipzig Fair for shocking West German and other Western exhibitors there by trying again and again to tie up its own purchases in the West with equivalent counterpart buying by its Western partners. "Compensation" thus assumes the character of a magic formula for the one side, and that of a shock for the other one, in the context of current discussions.

Accepting East European thinking therefore means transforming compensation transactions into the major tool for mobilizing Western capital and technology in order to circumvent high, and still rising, indebtedness, and yet to achieve the now as before very highly fixed development aims of the East European economies virtually without any slowdown. Citing examples of compensation exchanges which make sense for both partners, e.g. the delivery of big steel pipes in exchange for future natural gas supplies, the desire of the Eastern "buyers" is stated to be, e.g. the creation of new manufacturing industries or the rationalization of existing

production plants, through a bundle of intricately related agreements, by "paying" through firmly agreed deliveries of the East's own products in the future. It is hoped that, as in the case of the steel pipe agreement which operates satisfactorily, also in other sectors of the economy, the problem of redeeming the credits to be granted to the Eastern partner, which are indispensable for compensation trade as well, might be resolved, so-to-say, automatically. The need to sell Eastern products in the markets of the West for the purpose of earning the necessary foreign currency to pay for imports would then fall by the wayside, and/or selling Eastern goods would then become the task of the Western suppliers themselves.

However, from the point of view of the West and its free markets, not much good can be said of compensation trade, with the exception of a few cases. It is true that business transactions dealing with natural gas, gas line pipes, etc. — which in the last analysis, secure raw material supplies — are of mutual advantage even if they are tied to compensation agreements, but the same can hardly be stated as a general truth on behalf of the Western partner if and when the principle of compensation becomes the general rule. In order to convince Western companies of the great advantages of the compensation method, Eastern spokesmen often underline its benefits because the business connections would become firm in the long term and thereby easily calculable. Such arguments neglect the fact that Western companies, which are compelled to operate in conformity with market movements, must obey different rules, compared with any East European production unit. In marginal cases, it may even be possible that long-term purchasing guarantees for East European goods set up fatal risks for the very survival of an individual company, for the Western company will be forced to carry the risks of selling alone. This may grow even more dangerous because the Western partner is in no way able to influence the details of the production process in the Soviet Union or the detailed design of the Soviet product. In an extreme case, therefore, the Western partner may be expected to accept deliveries of products, about whose marketability he will never receive exact data, either at the moment of signing an agreement or on the future "Day X", when the produced goods reach him.

But even for the Eastern partner, compensation deals are of both short and longer-term disadvantage. Thus, it is a matter of course that the Western partner will accept goods he takes over in the way of a compensation exchange at extremely low prices. In the long term, the East European partners will be faced with the problem that they will not learn to tackle successfully the facts of the Western markets. Again expressed in other words: if marketing activities for selling Eastern products remain the task of the East's Western suppliers, Eastern exports to the West can, also in the future, scarcely be increased significantly, or the conditions will remain relatively unfavourable.

But it must still be admitted that both the German Federal Government and the German business community show some understanding for the desire of Eastern Europe to carry on compensation trade, and therefore they are, basically, prepared to examine seriously the possibilities of applying the principle of compensation. Relatively promising also in the future may be efforts to enter upon compensation deals, if their subject is the supply of East European raw materials. More frequently big companies or concerns can promise, in advance, to accept compensating supplies of Eastern goods. But even in the case of such big firms, such deals ought to be attempted only provided the products or semi-finished products can be made use of in their own production processes or sales organisation. But no German institution could be expected to support the making of compensation agreements as a general principle.

As a rule it will be difficult for individual German businesses to explain to their East European partners that and why they are basically not in favour of compensation deals, and therefore, it is imperative that Western governments never cease to enlighten their Eastern trading partners about the fact that compensation, *au fond*, is not a suitable tool for the furtherance of West/East European economic relations. Compensation deals will always remain an extremely primitive form of commerce, and if exaggerated use is made of them, they are likely to prejudice the system of the international division of labour.

Klaus Bolz