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REPORTS

CMEA

Borrowing in Western Financial Markets by Eastern European Countries

by Hans-Eckart Scharrer and Klaus Bolz, Hamburg *

What are the borrowing strategies and practices of European members of the Council for Mutual Economic Assistance (CMEA)? The authors had extensive discussions with bankers in the leading financial centres in Europe. Some of their findings are presented in the following article.

In the first ten years following World War II the economic relationships between East and West were close to zero. The basis for a gradual improvement of East-West relations, including economic relations, was only laid in the Sixties with the acknowledgement of the status quo by the West and the propagation of peaceful coexistence by the East. Yet, a rapid expansion of trade – and of CMEA trade deficits – did not take place before the end-Sixties/early Seventies. The main determinant of the trade expansion has been the CMEA countries' basic decision to accelerate their economic growth with the assistance of imported Western technology, bought on a credit basis. This policy was on the whole sustained despite a series of unexpected developments (crop shortfalls, oil price hike, increases in commodity prices, rising inflation in industrialised countries, world recession) which caused their trade deficits with the West, their hard currency borrowing and their indebtedness to rise rapidly.

Indeed, according to Western estimates the CMEA countries' net hard currency indebtedness has increased from \$ 7 bn to about \$ 50 bn in the seven-years period 1970–1977 (see Table 1). Of the total, about 30% is accounted for by the Soviet Union and 25% by Poland. In the course of the past year CMEA debt is likely to have been

augmented by another \$ 6–8 bn, raising its level to about \$ 55–60 bn net. Of the total net debt expansion of about \$ 45 bn between 1970 and 1977, \$ 33 bn fall into the second half of the period (1974–77), and \$ 13 bn into one year (1975). Whereas the growth of indebtedness accelerated until 1975 it has slowed down since then, both in absolute and relative terms. Yet, the level and growth of CMEA debt remain high enough to call for the continued attention of policymakers and banks.

Table 1
Net hard currency indebtedness of European CMEA countries 1970–1977

(estimates in billions of US dollars, at year-ends)

	1970	1974	1975	1976	1977
USSR	1.9	5.0	10.0	14.0	16.0
Bulgaria	.7	1.2	1.8	2.3	2.7
CSSR	.3	1.1	1.5	2.1	2.7
GDR	1.0	2.8	3.8	5.0	5.9
Hungary	.6	1.5	2.1	2.8	3.7 ^a
Poland	.8	3.9	6.9	10.2	13.0
Romania	1.2	2.6	3.0	3.3	4.0
Country total	6.5	18.1	29.1	39.7	48.0
CMEA banks ^b	.6	1.9	3.1	4.0	
CMEA total	7.1	19.0	32.2	43.7	(52) ^c

^a Original figure 3.4, own estimate based on revised BIS figures.

^b International Bank for Economic Cooperation (IBEC), International Investment Bank (IIB).

^c Other estimates, e.g. the one published by the Brookings Institution in September 1978, put the figure at \$ 46.0 bn. The difference is mainly due to a lower USSR estimate (\$ 12.0 bn).

Sources: Country estimates: CIA: Office of Economic Research; CMEA banks: Lawrence J. Brainard/Chase Manhattan Bank; CMEA total 1977: own estimate. The CIA and Brainard data have been chosen for their internal consistency. They are largely in accordance with estimates made by other authors.

* HWWA – Institut für Wirtschaftsforschung – Hamburg. The article reproduces some findings of a study prepared for the Organisation for Economic Co-operation and Development (OECD). The views expressed are the sole responsibility of the authors and they should not be considered as reflecting the official position or endorsement of OECD member countries or of the Secretariat. The complete study will be published this summer by Verlag Welt-archiv GmbH, Hamburg.

The most important single element in (the rise of) hard currency debt has been liabilities to Western banks. Bank financing is accounting for an estimated 63% of the CMEA's gross liabilities and 58% of the group's net liabilities to the West (end-1977). Again, expansion was most pronounced, both in gross and net terms, in 1975 (see Table 2). In 1976 gross indebtedness increased at a somewhat slower rate (except for the GDR, Hungary and — due to its very low initial debt level — the CSSR); at the same time deposits in the West were generally augmented noticeably. However, it was not before 1977 that a major change took place. In that year, CMEA countries' gross bank indebtedness did not rise by more than \$ 4.1 bn, and net indebtedness by only \$ 3.9 bn.

The slower pace of borrowing in 1977 appears mainly to reflect the CMEA countries' growing concern about the levels of their hard currency indebtedness and the rates of their increases. Reluctance to lend on the part of Western banks does not seem to have played a dominant role. In 1978 liabilities to Western banks were again accelerating: in the first half they expanded by \$ 4.1 bn net.

Indebtedness to banks encompasses a great variety of CMEA liabilities: one-day call or term money and other Euromoney-market instruments; irrevocable and unconditional 1/2–5 years promissory notes bought by Western banks from exporters on a non-recourse basis; 6–8 years syndicated Euro-currency loans; officially guaranteed

Table 2
Domestic and foreign currency positions of banks covered by the BIS reporting system
vis-à-vis European CMEA countries^{a, b} 1974–1978 Q 2
(in millions of US dollars)

	Banks covered by BIS Reporting System ^c					
	old coverage ^d				new coverage ^e	
	1974	1975	1976	1977	1977	1978 Q 2
Banks' claims on:						
USSR f C, U	3,306	7,597	10,345	10,554	11,618	12,210
Bulgaria	1,098	1,600	1,973	2,318	2,640	2,926
CSSR	275	288	866	1,259	1,519	1,816
GDR	1,665	2,575	3,575	4,149	4,870	5,355
Hungary	1,497	2,194	3,051	4,219	4,772	5,413
Poland U	2,076	3,870	5,442	6,791	9,076	10,171
Romania	755	880	732	1,186	1,419	2,033
Residual H, C, J, U	1,913	2,499	2,750	2,407	2,407	2,305
Total CMEA	12,585	21,503	28,734	32,883	38,321	42,229
in % of World total	3.8	4.9	5.2	5.0	5.6	5.8
Banks' liabilities to:						
USSR f C, U	3,232	2,854	3,724	4,221	4,362	4,107
Bulgaria	253	282	355	445	492	515
CSSR	315	250	356	444	454	536
GDR	422	556	616	706	882	986
Hungary	468	748	899	872	1,068	808
Poland U	407	508	643	379	399	690
Romania	135	374	295	194	199	233
Residual H, C, J, U	675	688	595	455	455	373
Total CMEA	5,907	6,260	7,483	7,716	8,311	8,248
in % of World total	1.6	1.4	1.4	1.2	1.2	1.2
Banks' net positions vis-à-vis:						
USSR f C, U	— 74	4,743	6,621	6,333	7,256	8,103
Bulgaria	845	1,318	1,618	1,873	2,148	2,411
CSSR	— 40	38	510	815	1,065	1,280
GDR	1,243	2,019	2,959	3,443	3,988	4,369
Hungary	1,029	1,446	2,152	3,347	3,704	4,605
Poland U	1,669	3,362	4,799	6,412	8,677	9,481
Romania	620	506	437	992	1,220	1,800
Residual H, C, J, U	1,238	1,811	2,155	1,952	1,952	1,932
Total CMEA	6,678	15,243	21,251	25,167	30,010	33,981

a CMEA totals in this table differ slightly from BIS (Bank for International Settlements) figures on Eastern Europe as Albania have been excluded.

b Excluding positions of banks located in Germany vis-à-vis the German Democratic Republic.

c For banks in Canada, Japan, Switzerland and the United States the country breakdown is less than complete and its extent is indicated by the use of the letters C (Canada), J (Japan), H (Switzerland) and U (United States).

d Banks in Group of Ten countries and Switzerland and branches of US banks in the Caribbean area and the Far East.

e Old coverage plus banks in Austria, Denmark and Ireland.

f Including CMEA banks (IBEC, IIB).

Sources: Bank for International Settlements, Quarterly Eurocurrency tables.

buyer credits (at fixed or floating interest rates) of up to 8 years maturity and more; and 8–15 years bonds kept in the banks' own portfolios – to mention just a few. Whereas most Euro-currency loans represent in fact untied balance-of-payments financing (irrespective of the stated loan purpose) as do funds raised in the money market or by bonds issues, other sources of bank finance are tied to goods purchases in the respective country. On the whole the rapid growth in bank indebtedness since the early Seventies indicates the CMEA countries' desire of – and success in – securing more funds for universal use.

Different Fund-raising Strategies

Most successful in this respect has been Hungary, the country with the highest proportion of bank credits (over 90%). There, the authorities are reportedly taking the view that by offering cash payment for their goods purchases their bargaining position with regard to prices, delivery terms, etc., is substantially improved. They have therefore completely separated the purchasing of imports from their financing, the foreign exchange being pro-

vided by the National Bank which for this purpose is tapping the Euro-currency market. In contrast to this positive interpretation of the Hungarian practice it has also been argued that the country because of its relatively low share of machinery imports – the lowest in the CMEA – may not be able to raise more officially supported export credits in the West. In any case the National Bank has been able to attract substantial amounts at favourable rates in the Eurocredit and Euro-bond markets, i.e. in the form of untied balance-of-payments finance.

Turning to the USSR, Poland and the GDR, countries closer to the CMEA average proportion of bank liabilities, their structure of indebtedness can be explained by several factors: a financial strategy making deliberate use of the often low interest rates and credit periods of official export finance; a larger share of plant and machinery, qualifying for such financing, in total imports from the West; certain difficulties in raising sufficient "untied" Euro-currency funds to cover their scheduled trade deficits. All interpretations have some plausibility. In addition, in the case of the

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NEW PUBLICATION

Klaus Bolz (Ed.)

DIE WIRTSCHAFTLICHE ENTWICKLUNG IN OSTEUROPA ZUR JAHRESWENDE 1978/79

(The Economic Development in Eastern Europe at the Turn of the Year 1978/79)

This study offers a survey by countries of the economic results of the preceding year and the development trends of the current year in the CMEA countries (Bulgaria, GDR, Poland, Rumania, Soviet Union, Czechoslovakia, and Hungary). The composition of the contents of the individual country reports and of the added statistics is formed homogeneously. The materials available up to mid-March 1979 have been taken into consideration. Volume and topicality of the analyzed data are thus orientation and decision aids that in such a concise form can hardly be found anywhere else. (In German.)

Octavo, approx. 280 pages, 1979, price paperbound DM 18,50

V E R L A G W E L T A R C H I V G M B H - H A M B U R G

Soviets a deep-rooted faith in inter-governmental financial protocols which is part of their basic political philosophy, lends itself for an explanation of the large share of officially supported credits in total debt.

Czechoslovakia and Romania, the countries with the lowest proportions of bank indebtedness (40 and 30%, respectively), are at the same time the countries with the lowest overall indebtedness, measured in terms of the debt/export ratio. In other words: they are the financially most conservative countries, an interpretation which conforms with the general view among bankers. Their financial conservatism expresses itself *inter alia* in their adherence to the "classical" instruments of trade finance (supplier and buyer credits, both secured and unsecured, in the forms of documentary credits, commercial bills, promissory

notes, and bank loans and credits tied to specific trade transactions). Balance-of-payments financing on an untied basis via syndicated Euro-currency loans and credits is a relatively advanced method of macroeconomic financial management (as is the issuance of bonds in the international market or active participation in money market operations). It appears, therefore, that it is not only the commodity structure of imports from the West which accounts for their low share of bank liabilities but a certain lack of financial flexibility and sophistication, too.

Large Proportion of Euro-currency Financing

About two thirds of Western banks' total exposure to CMEA countries represent foreign currency lending (see Table 3). Of the domestic currency portion of \$ 12.6 bn (year-end 1977), 37% was

Table 3
Reporting banks' total positions and positions in foreign currency vis-à-vis European CMEA countries 1970-1978 Q 2

(in billions of US dollars)

	Total positions a vis-à-vis CMEA	Foreign currency positions vis-à-vis CMEA (European reporting countries b only)					Domestic currency positions vis-à-vis CMEA		
		Total c	London	Luxembourg	Germany	Italy d	U. S.	London	Germany
Banks' claims on CMEA									
1970	n. a.	2.15	n. a.	n. a.	n. a.	.7	.1	n. a.	n. a.
1973	n. a.	7.4	2.8	.5	n. a.	.6	.4	n. a.	n. a.
1974	12.6	10.1	4.5	.7	n. a.	.3	.6	n. a.	n. a.
1975	21.5	15.9	6.0	1.3	.6	.6	.9	n. a.	2.7
1976	28.8	20.8	8.0	2.5	.9	.6	1.1	n. a.	3.8
1977 A	32.9	23.8	8.9	3.0	1.1	.6	1.1	1.1	4.6
1977 B	38.3	25.7	8.9	3.0	1.1	.6	1.1	1.1	4.6
1978 (June)	42.3	28.5	10.2	3.4	1.3	n. a.	n. a.	1.2	4.8
Banks' liabilities to CMEA									
1970	n. a.	1.65	n. a.	n. a.	n. a.	.3	.1	n. a.	n. a.
1973	n. a.	3.7	1.2	.1	n. a.	.1	.1	n. a.	n. a.
1974	5.9	5.1	2.0	.3	n. a.	.1	.3	n. a.	n. a.
1975	6.3	5.4	1.6	.6	.1	.6	.2	n. a.	.2
1976	7.6	6.4	2.0	.6	.3	.8	.3	n. a.	.2
1977 A	7.8	6.4	1.8	.5	.2	.7	.2	.1	.4
1977 B	8.4	7.0	1.8	.5	.2	.7	.2	.1	.4
1978 (June)	8.3	6.9	1.9	.6	.2	n. a.	n. a.	.1	.3
Banks' net positions vis-à-vis CMEA									
1970	n. a.	.5	n. a.	n. a.	n. a.	.4	.0	n. a.	n. a.
1973	n. a.	3.7	1.5	.4	n. a.	.2	.2	n. a.	n. a.
1974	6.7	5.0	2.5	.4	n. a.	.1	.3	n. a.	n. a.
1975	15.2	10.5	4.5	.7	.5	.1	.7	n. a.	2.6
1976	21.2	14.4	6.0	2.0	.6	-.3	.8	n. a.	3.6
1977 A	25.1	17.4	7.1	2.6	.9	-.1	.9	.9	4.2
1977 B	29.9	18.7	7.1	2.6	.9	-.1	.9	.9	4.2
1978 (June)	34.0	21.6	8.3	2.8	1.0	n. a.	1.1	n. a.	4.4

a Up to end-1977 (1977 A): Domestic and foreign currency positions of banks in Group of Ten countries and Switzerland and of the foreign branches of US banks in the Caribbean area and the Far East. Since end-1977 (1977 B): Including Austria, Denmark and Ireland.

b Up to end-1977 (1977 A): Belgium-Luxembourg, France, Germany, Italy, Netherlands, Sweden, Switzerland, United Kingdom. Since end-1977 (1977 B): Including Austria, Denmark and Ireland.

c Excluding positions of banks located in Germany vis-à-vis the German Democratic Republic.

d Dollar position only.

Sources: Bank for International Settlements, Report on Euro-currency and other international banking developments (quarterly); Bank of England, Quarterly Bulletin; Commissariat au contrôle des Banques, Luxembourg, Bulletin Trimestriel; U. S. Treasury Bulletin; Deutsche Bundesbank, Statistische Beihette zu den Monatsberichten, Reihe 3; Banca d'Italia, Assemblea Generale Ordinaria dei Partecipanti, Appendice; IMF, International Financial Statistics; Own Calculations.

accounted for by German banks, another 9% each by banks domiciling in the US and in London. The Swiss share is probably near \$ 1 bn. The balance of about \$ 5 bn is made up by banks in other countries. The picture is somewhat distorted by the fact that in Germany officially supported export credits extended by banks (buyer credits) are recorded among banks' claims on foreigners whereas in most other countries they are treated as claims on the official export finance (and guarantee) institutions, e.g. in Britain the ECGD (Export Credits Guarantee Department).

As to Euro-currency lending, 35% of the banks total claims on CMEA of \$ 25.7 bn at year-end 1977 (viz \$ 8.9 bn) were held by London banks, another \$ 3.0 bn by banks in Luxembourg and \$ 1.9 bn by banks in Vienna. Of the remaining \$ 11.9 bn, the exposure of German and Italian banks was accounting for \$ 1.7 bn, exposure of banks in Belgium, the Netherlands and Switzerland for another \$ 3.5-4 bn. The most important financial centre next to London for Euro-currency business with CMEA countries is no doubt Paris, with an estimated \$ 5.5-6 bn claims at year-end 1977.

CMEA countries' deposits with Western banks have continually been rising until end-1977, al-

though in the course of the years as well as among individual countries some fluctuations are observable. More than 80% of total CMEA deposits are held on the Euromarkets. About one third of the Euro-currency position is with London and Luxembourg banks, some 8% with banks in Vienna and a major part of the rest is likely to be held in Paris.

It is mainly due to the important German position in East-West trade that Frankfurt has become a major centre of CMEA financing. The same is true for Luxembourg where most of the supplementary Euro-currency financing of German exports is undertaken. Besides that, Luxembourg has developed to become a financial centre of its own right, with close connections to the other Euromarket centres (notably London and Paris). In Paris, too, export-related medium and long-term Euro-currency financing (of French exports) appears to be of major importance. In addition to that, however, a great deal of "genuine" short-term Euro-currency trading with Socialist countries is taking place there. It is not only the "Eurobank" (Banque Commerciale pour l'Europe du Nord), the largest Eastern banking establishment in the West, but also the French banks themselves which are actively participating in this business. London is

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Rolf Jungnickel, Henry Krägenau, Mathias Lefeldt, Manfred Holthus

EINFLUSS MULTINATIONALER UNTERNEHMEN AUF AUSSENWIRTSCHAFT UND BRANCHENSTRUKTUR DER BUNDESREPUBLIK DEUTSCHLAND

(The Influence of Multinationals on West Germany's Foreign Trade and Industrial Structure)

The present study examines for the first time comprehensively to what extent the multinational corporations influenced the German economy's structural change and how far they had effects on the competitive situation and the allocation of resources within the individual industries. Moreover, the study analyses the extent to which volume, direction and composition of the German external relations are being determined by the multinationals' activities (in German).

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V E R L A G W E L T A R C H I V G M B H - H A M B U R G

beyond any doubt the major centre for both short-term Euro-currency trading and medium-term syndicated loan financing. US banks, the major providers of "untied" balance-of-payments financing, are operating from London. It is therefore due to "objective" factors that London is accounting for a high proportion of the CMEA countries' total financial business with the West.

Table 4
Maturity distribution of banks' claims, and undisbursed credit commitments to CMEA countries, at year-end 1977

	Amounts outstanding \$ mn	Percentage maturity ^a in			Un-disbursed credit commitments ^b \$ mn
		1978	1979	1980 and after	
USSR	11,736	55.2	8.1	36.5	4,152
Bulgaria	2,764	59.3	10.2	30.3	509
CSSR	1,546	57.8	3.3	38.0	214
GDR	5,275	54.2	18.1	27.2	942
Hungary	5,005	60.4	7.4	30.6	240
Poland	8,840	37.9	16.2	45.3	3,057
Romania	1,387	66.8	6.6	26.0	481
CMEA total	36,553	52.4	11.3	35.7	9,595

Note: Reporting countries include the Group of Ten, Switzerland, Austria, Denmark and Ireland. Included are bank branches in the off-shore centres and, in addition, subsidiaries of US banks in these centres.

a Roll-over lending is classified according to the ultimate maturity of the loan and not to the next roll-over date.

b Excluding commitments of banks in Canada, Italy, the Netherlands and Switzerland and of their foreign affiliates.

Source: Bank for International Settlements; own calculations.

The maturity distribution of banks' claims to CMEA countries and the unused credit commitments at year-end 1977 are shown in Table 4. Judged by these data, the situation does not appear to give rise to serious concern. A large proportion of the claims which expired in 1978 were current credits, partly on a daily call basis, the sum of which is in practice "never" called, however. Also, mail credits and short-term money deposits with banks in Socialist countries go into this position. Therefore the figures for 1978 look much worse than they actually are. The amounts falling due in 1979, 1980 and thereafter appear generally to be manageable given the improvement in most CMEA countries' trade accounts. This statement holds also when interest payments — not included in the figures — are added. The only country which on the basis of these data may be facing difficulties, is Poland: \$ 1.4 bn of its bank liabilities are due for repayment in 1979, \$ 4.0 bn in 1980 and thereafter.

However, the table provides a partial picture only: it is confined to the maturity distribution of CMEA countries' bank indebtedness. Liabilities to Western non-banks which may account for up to 70% of a country's total hard-currency indebtedness are not included. Information on the maturity structure of officially supported export credits, the

major component of non-bank indebtedness, is not available.

Positive Attitude of Western Bankers

Bankers are generally taking a rather positive view on lending to CMEA borrowers. Under the present conditions of abundant bank liquidity and slack credit demand from first-rate corporate borrowers, lending to the CMEA appears superior to most alternatives. In interviews with numerous bankers we found no serious doubts as to the willingness and ability of CMEA countries to keep their hard-currency indebtedness under control and to service their debts as accurately in future as in the past. Moratoria or demands for debt renegotiations by either an individual CMEA country or the bloc as a whole are practically being ruled out. The idea that any CMEA country should default by accident (i.e. by economic mismanagement) and that the USSR and other members of the group would remain passive in this event is considered a most unlikely possibility. However, no bank would drive the "umbrella" theory so far as to dispense with making individual country assessments and defining, however vaguely, a "desirable" lending structure.

CMEA countries are generally considered as being financially conservative (though at varying degrees), with an inherent reluctance to enter into continuous, large trade and current account deficits and to accumulate large external debts. Neither the level nor the more recent growth of foreign indebtedness are regarded as being excessive (with the possible exception of Poland). The level of debt is considered moderate not only in relation to the CMEA countries' economic potential but also to foreign indebtedness of certain developing countries. The heavy trade deficits in 1973, 1974 and especially in 1975 and the resulting fast increase in hard-currency debts are looked upon as being to some degree accidental. The reduction of the CMEA deficit in 1976 and more in 1977 is generally interpreted as signalling a return to a more "normal" structure of the current account.

It is an open question whether the CMEA countries will continue their policy of reducing their trade deficits with the West in 1979 and thereafter. The CMEA's need for Western technology is certainly unchangedly high and even growing, given their ambitious economic goals. Indeed, it is not sure but quite likely that CMEA countries will again accelerate their borrowing in the near future — possibly on the basis of a new borrowing concept. The principle of self-liquidating credits may become still more important than in recent years. The request for compensation deals is also likely to increase considerably.