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Private Financing of East-West Trade and Investment

I am in some very real sense off my own turf this morning. I am a practicing international banker, not a lawyer, not a government official. As a practicing international banker, that simply means I lend to customers whose residence is outside the continental limits of the United States.

Without for a moment attempting to inject a sour note into the proceedings, I intend to share with you in a somewhat detailed fashion the outlook and concerns of a major international bank when asked to lend to the Soviet government or another COMECON government, to finance a United States export into the Eastern Bloc, or from time to time to lend to a joint venture.

Two years ago, it was fashionable for all major international banks to be developing ambitious plans to become rapidly involved in COMECON countries. They seemed to offer a virgin market of enormous proportions, and one year ago, to change the metaphor, most of us were at that point with a foot in the door and waiting with some impatience for the passage of the Trade Act. However, time and circumstances have changed. A congressional campaign to use economic leverage to change Soviet emigration policy dampened much of the heady enthusiasm in Washington board rooms, New York board rooms, and public relations offices. The Trade Act of 1974 and subsequent Soviet reactions abruptly ended the more extravagant hopes of American business born in 1970, 1971, and 1972.

I think it is generally agreed now in the American business community that the difficulties in expanding trade with COMECON countries were greatly underrated a couple of years ago. Total Soviet imports in 1974 were $27 billion, of which a little over half came from other Communist countries. In terms of the context of United States foreign trade, these are not staggeringly important figures. West Germany has been the U.S.S.R.'s most important Western foreign trade partner. Fifteen years ago, the Soviet Union was fifteenth on Western Germany's trade list. Today, they are thirteenth. Under the most optimistic of assumptions, the United States in 1980 might account for four percent of Soviet exports and six

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percent of her imports. Even these modest goals presuppose MFN status and continued progress toward détente.

I think we have to make genuine distinctions between the financial circumstances of the Soviet Union on the one hand and of the other COMECON countries on the other. Some months ago, the U.S.-U.S.S.R. Trade and Economic Council suggested that sixty percent to seventy percent of all Soviet imports from the United States would have to be financed. On the other hand, the United States press gave substantial publicity to a recent CIA study which indicated that the U.S.S.R., due to high prices of exports, may have enjoyed a $1 billion foreign trade surplus last year. That study forecast that Soviet exports to the West might increase from $7.5 million this year to $25 billion or $30 billion in 1985. It would appear logical to assume that the Soviet Union will be able to pay for a substantial volume of goods she wants to purchase from us within substantial trade credits. On the other hand, it has been authoritatively estimated, and one can do nothing but make estimates in these cases, that the international debt of the other Eastern European countries today may be $10-15 billion. It is estimated that last year, the Socialist countries, excluding the U.S.S.R., had an aggregate trade deficit with the West of $8 billion. If these trends continue, the other COMECON countries might have an external debt to the West of $15-30 billion by 1985, and they will, indeed, require financing if they are to make substantial purchases from the United States and other Western European countries.

The whole area of national export credits lends itself to humor if you are at all cynical. A couple of weeks ago, *Barron's* reported that the Soviets have bought $6 million worth of telecommunications equipment from France, with financing offered at a rate of 7 percent. At the same time, my own bank was financing $29 million of imports of telephone equipment into France at a rate substantially in excess of that. Great Britain has offered the Soviet Union a line of $2.5 billion at a rate of approximately 7.5 percent, while being forced to borrow in international markets at anywhere from 12 to 14 percent to finance her own trade deficits. One has to wonder for how long and for what tenor other Western nations are going to be willing to do this, how much they are going to be willing to pay, and how much risk they are going to be willing to assume in order to finance their own exports to the Soviet Bloc.

The entire United States international banking and business community deplores the fact that MFN status has not been granted generally. We deplore the fact that there are limitations on Eximbank financing to the Soviet Bloc. But I think in some sense the international business community has overstated its case. The present mild crisis in the United States-Soviet relations does not constitute an irreparable breakdown in our trade relations but may have served simply to dispel a wide range of illusions which grew up a couple of years ago, and which would have been dispelled sooner or later if Congress had not tampered with the Trade

Act. It has been said repeatedly that a great opportunity has been lost in the Trade Bill, but one wonders whether even under optimal conditions, the volume of trade, for example, between the United States and the Soviet Union or the United States and the other Eastern Europe countries would ever be of critical importance to either. I think it is important that this be placed in context. I wonder if the whole subject couldn't do with a period of benign neglect, during which time, without speeches, without conferences, without congressional investigations, East-West trade could grow in a quiet, organic, natural way, dependent upon the resourcefulness and ingenuity of lawyers, on the one hand, and Socialist officials and American businessmen on the other.

Another aspect of change in the banking communities, another aspect of doing business with COMECON countries has been more financial than geopolitical. We have moved in the world of international finance into a lender's market. American banks, like banks throughout the Western world, are under substantial constraints not to increase loans. We are under the constraint of capital inadequacy within our own respective institutions.

For the past several years, regulatory authorities in this country have expressed repeated concern about the volume of our risk assets in relation to our capital. In a worldwide climate of higher demand for loans than available resources, we have had to make some hard choices. This has forced us to be more selective in regard to risks and more demanding with respect to rewards.

Let us take a look at an actual transaction that came across my desk recently. It involved a large, stable, financially respected Socialist country wishing to lease certain equipment to develop energy resources. Representatives of the country were interested in a lease because it involves special features of no down payments, equal payments over a period of time, and a fixed interest rate. From my point of view, a financial lease to a Socialist country is simply a term loan at fixed interest rates, since we are not concerned with repossession of the equipment in that country. In view of the large size of the order, delivery will take place two years from now. The debtor has suggested that payment be spread over a ten-year period. We, therefore, need to measure this proposal, which is a typical proposal in a major international bank, against some of our current lending criteria.

The borrower, or lessee, is seeking a credit at a fixed rate of interest for ten years, which, in the first place is unacceptable, primarily because we banks are totally skeptical of our ability to forecast our money costs for that long. Only recently have some Socialist country banks been willing to pay floating interest rates. Even with a margin of one and one-half percent over the cost of money, it is doubtful we could sell a ten-year loan today. It is becoming increasingly difficult to interest American banks or Western European banks in loans of this tenor. The COMECON borrower, on the other hand, has a reputation so solid and so financially secure that we feel we might consider an exposure of eight years. This would involve a two-year period for the manufacturer to assemble, fabricate, and ship the equipment. During this period, we would collect a commitment fee.

We have had a very difficult time trying to convince our friends in COMECON countries that in order to tap the United States' financial and international banking markets for significant sums of money, they are simply going to have to pay commercial rates. This has been a difficult task for a number of reasons, part of which are our own fault. In the first place, the Soviets and other COMECON countries enjoyed what, in hind sight, appears to be absurdly low rates of interest in the late 1960s and early 1970s—three-eights or one-half percent over the cost of money on a ten-year loan. Secondly, this phenomenon arose because the Socialist countries are smart enough to have only one borrower, and a steady stream of bankers goes by Dr. Salusinszky's office offering him untold quantities of money at very preferential rates which, obviously, puts them in an extremely good bargaining position.

Our perceptions as to what is attractive business have changed substantially in the last year or two. The most crucial consideration in lending money is not lending it but getting it back. Or, as the lady says, she has no fear of flying, just of crashing. We are all familiar with the scrupulous payment record of the COMECON countries. But in international banking, I have come to the conclusion that the inevitable seldom occurs, and the unforeseen, always. The probability of unforeseen events occurring in the next ten years bears a mathematical relationship to the length of time our loan is outstanding. More dangerous than the unprofitable operations of the enterprise itself would be a national shortage of convertible currency. But, here again, their ability to handle their affairs in this area has been exemplary. Socialist countries of Eastern Europe have enjoyed an extraordinary credit rating among Western banking circles, despite the fact that we don't have data on their balance of payments, their level of international reserves or the burden of their international indebtedness. Why? For two reasons: 1) the excellent historical record; and 2) the monopoly of foreign trade and foreign currency operations which permit them to deal rapidly and effectively with any foreign exchange problem.

One last factor which forces us to be selective in dealing with COMECON countries is a constraint known in the trade as our legal lending limit. The law provides that no bank can lend to any person, partnership, or corporation an amount in excess of ten percent of its capital and reserves. The exception to that is a loan to a foreign government or an institution which bears the full faith and credit of a foreign government. So far, the COMECON countries have been unwilling to provide private United States banks their full faith and credit guarantee on the obligations of the foreign trade banks in their countries. That means that a bank like my own, the fourth largest in the United States, has a total practical legal lending limit in most COMECON countries of $100 million, whereas there are a great many developing countries in the world where we have more than that at risk. We have an internal house limit of somewhat less than that for each individual borrower.

Consider if you will the total legal lending limit of all American banks. It is something like $2.5 billion. Of this amount, about $300 million, for example, is already at risk with the U.S.S.R.'s Vneshtorgbank. Of the remaining sum, it would be my estimate that one-half will not be lent under any circumstances, and that is so for several reasons, not the least of which is a great many American banks are not in international banking.

We are left with less than $1 billion of total credit which can now be lent to the Soviet Union by the entire American banking system. This may sound like a lot of money, and, indeed, it is, but within my own bank in the last several months, two projects have been discussed by American corporations, each one of which would take half of the entire remaining legal lending limit of the American banking system.

Another United States bank, a California bank, has offered a credit line to the Soviets which would take up the other half, and, at that point, we are out of business.

A last nagging problem for which I ask the American Bar Association's counsel. The Johnson Debt Default Act of 1934 continues to nag us. It is interpreted as meaning that it is a criminal offense for any bank or person in this country to extend a loan to Czechoslovakia, Hungary, Poland, the Soviet Union, or, possibly, the German Democratic Republic, except for the normal financing of United States export sales.

As all of you know, we consider, for reasons that aren't entirely clear to me, loans to these countries which go far beyond the normal export sales pattern. Banks are often asked to make this kind of loan, and I ask you lawyers what our response should be.