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CENTRAL INTELLIGENCE AGENCY
WASHINGTON, D.C. 20505

22 May 1975

MEMORANDUM FOR: Mr. Stephen H. Goodman
Vice President for Policy Analysis
Export-Import Bank
Washington, D. C.

SUBJECT : Western Credits to the USSR and Eastern Europe: Policies and Implementation

1. Attached is the information you requested early this week concerning Western credit policies and practices vis-a-vis the USSR and Eastern Europe. The countries covered are France, Italy, West Germany, the United Kingdom, and Japan. One or two of the most recent credits or credit lines are included for each of the five countries. Information on earlier credits can be found in the attachment to our memorandum forwarded to Mr. John Huber in mid-February, a copy of which is attached.

2. If we can be of any further assistance, please let us know.

Office of Economic Research

Attachment:
As stated

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France

The French export financing system allows for the granting of medium-term and long-term export credits at subsidized fixed rates of interest. Two institutions -- the Compagnie Francaise pour l"Assurance du Commerce Exterieur (COFACE) and the Banque Francaise pour le Commerce Exterieur (BFCE) -- are instrumental in implementing the system. COFACE provides government insurance for a variety of export risks, while BFCE is generally responsible for mobilizing the financial resources.

EEC countries aside, Communist and non-Communist countries are eligible for subsidized, fixed-rate financing, provided that the credits are insured by COFACE. There is no special policy for Communist countries, although most are considered to be prime risks.

The French Treasury, the Banque de France, BFCE, and participating commercial banks provide the sources of finance for medium and long-term credit: commercial bank credit, central bank credit, BFCE borrowing on the commercial market, and transfers from the Treasury to BFCE.

These financial sources are blended in such a way as to produce "all-inclusive" (i.e., subsidized) interest rates to the borrower. For example, there is a rediscounting facility at the Banque de France -- via BFCE -- for medium-term export paper during the last three years of its maturity

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at advantageous rates (4.5% as 1 July 1974). Also, there is a provision for the consolidation of all maturities of more than seven years at subsidized rates by BFCE out of funds either advanced directly by the Treasury or raised on the financial market under government guarantee.

The conditions for financing and insuring French credits to the USSR are set down in agreements, renewed every five years, between the USSR State Bank and five French commercial banks, which act as channels for financing French exports. A French exporter must request a supplier credit through one of the five contracting French banks. In practice, however, the credits are divided among the entire French banking community. Buyers credits are also available to the USSR but are rarely used because they could add a full percent in interest.

The December 1974 Franco-Soviet credit agreement provided a $2.8 billion line of credit valid for five years: $0.7 billion reportedly were allocated for small and medium size transactions; $1.5 billion for large projects, and $0.6 billion for steel pipe and pipeline construction. The credits are repayable over 8½ years at interest rates of 7.2% to 7.55% -- depending on the size of the transactions. These rates compare favorably with current market rates but are higher than those on previous French credits to the USSR. A clause in the agreement provides for a renegotiation of the minimum interest rate -- applicable for large value projects --

after 2½ years, and a renegotiation of the maximum rate -- applicable for smaller value transactions -- after one year. Finance for ship construction, however, complies with the OECD protocol limiting the minimum interest rate to 8%.

France routinely makes credits available to East European countries under the same general conditions as those for the USSR. In May 1974, for example, it was reported that France was doubling its credits to Poland for the purchase of French goods to some $900 million by the end of 1975. The interest rate was in the range of 6% to 6.6%.

Italy

Financial support from the Italian government enables Italian banks to offer the USSR and East European countries low-interest fixed rate credits in support of Italian exports. Soviet and East European purchases may be financed either on a supplier or buyer credit basis. In all cases loans are initially made by one of several major medium-term Italian credit institutions -- Istituto Mobiliare Italiano (IMI), Mediobanca, Efibanca. An official rediscount agency -- Mediocredito -- enables these banks to offer low-interest credits. Government funding allows Mediocredito to either refinance the export credits provided by the banks or to pay interest rebates directly to the banks.

The loans granted by the medium-term banks must also carry government insurance guarantees to qualify for the Mediocredito support. Such insurance is issued on a case by case basis by the Istituto Nazionale della Assicurazioni (INA), a government-operated agency which is administered under the joint control of the Ministries of Foreign Trade, Foreign Affairs, Treasury, Industry and Commerce, and the National Institution for Foreign Trade. INA reviews each application for the creditworthness of the borrowing country and the credit terms which have been offered by the banks.

The Soviet Union has sought to gain Italian agreement to the establishment of sizeable credit lines to cover Soviet purchases over a period of several years. Such inter-governmental agreements would in turn, guide INA (and subsequently Mediocredito) operations during the period in question. The Italians are not anxious to grant subsidized credits to a developed nation and have been limited by domestic economic difficulties in their ability to grant such subsidies. The Italians recently refused to grant a blanket line of credit to the USSR and told the Soviets that the availability of subsidized credits will be decided by the government on a case by case basis prior to contract signing. Italian government officials have admitted, however, the subsidized credits to the USSR will be made, but on a more controlled basis than in the past.

In April 1975 the Italian government agreed to provide subsidized credits to support the sale of over $300 million in signed contracts for chemical plants to be delivered to the Soviet Union. The credit calls for a downpayment of some 20% and carries an effective interest rate of 7.345%. The credit will run for eight years from the time of delivery. While no recent information on Italian credits to East European countries is available, Italian exports to these nations are presumably financed on a similar basis. It is unlikely, however, that Eastern Europe has been able to gain credits on terms as favorable as those granted to the USSR, where particularly large orders hang in the balance.

West Germany

Soviet and East European imports of West German capital goods are financed at market rates on a supplier credit basis. Although the West German government provides commercial and political risk insurance and a special rediscounting facility for trade credits, it does not directly subsidize interest rates for trade credits or otherwise play a major role in the mobilization of funds in support of capital goods exports to the USSR or Eastern Europe.*

Requests for insurance and financial credits are initiated by the exporter. Trade credits are normally provided by the AKA (Ausfuhrkredit GmbH), a consortium of German commercial

*Swing credits granted to East Germany are the exception.

banks which is supported in part by a special line of rediscount credit made available by the Bundesbank. The use of Bundesbank facilities can reduce interest rates by some 2% below market levels, but the rediscounting facility is available only for the first four years following the contract signing or -- depending upon lag time -- for the first 2-3 years of the credit extended upon delivery. As a result, for longer term credits, the major portion of export financing is provided by the AKA without any government assistance. The rate of interest varies and is usually about 1/2% below the long-term market rate. When insurance and other costs are included, the effective interest rate for export credits approach the market rate of interest.

Political and commercial risk insurance is required for AKA funding and is made available by Hermes Kreditversicherungs AG, a private company which has been given the responsibility for providing official export credit insurance for supplier credits. Requests for insurance are reviewed by Hermes on a case-by-case basis, with particular attention paid to the credit terms to be made available. (In most instances Hermes attempts to keep West German credits within Berne Union guidelines.)

Nominal interest rates on loans advanced to the USSR and Eastern Europe are usually denominated at rates well below market levels (6% to 7%). In these instances the West

German exporter makes arrangements with banks to cover the costs accruing from this differential. The exporter, in turn, increases his selling price (with full Soviet knowledge) to cover the anticipated cost of this subsidy.

The recent Soviet contract for large diameter pipes exemplifies the type of trade financing available in West Germany. The 8 1/2 year loan calls for a 15% downpayment to be repaid at a fixed 6.75% interest rate. The 1.5 billion DM credit was made available by a consortium of 43 West German banks at market rates (presumably using the AKA facilities). Mahnesmann, the supplier of the pipes, and Ruhrgas, the purchaser of the natural gas the USSR will deliver in repayment for the pipes, are to jointly absorb the difference between market rates of interest and the fixed rate of the loan. This cost is being passed through in the prices received for the pipe and paid for the gas.

West German financing of trade with Eastern Europe is financed in the same manner, although no examples of recent credit extensions are currently available.

United Kingdom

The UK government does not have any specialized institution providing export credit financing. Under arrangements concluded with the government and operated by the quasi-government insuring organization, Export Credits Guarantee Department (ECGD), however, the private UK clearing banks and merchant banks have provided export credits at subsidized fixed rates of interest.

Credits of two years or longer insured by ECGD are eligible for subsidized rates of interest. All countries, including Communist countries, are eligible for ECGD insurance, which covers political and commercial risks. Since UK entry into the EEC, however, it appears that other EEC member states are not eligible for subsidized credits.

Under the ECGD guarantee system, the clearing banks provide cash for exports up to the equivalent of 18% of current account deposits. For this, they charge the borrower the subsidized, fixed rate of interest and receive from ECGD the difference between the subsidized rate and the commercial rate of interest. For amounts over the 18% level, ECGD refinances the banks.

ECGD-backed loans take the form of both supplier credits and buyer credits. The latter is the type generally employed in financing UK exports to the USSR. Usually, there is an intergovernmental agreement that ECGD will insure a specified amount of credit, which must be taken up within a specified time. Accordingly, a British bank then makes available a sum to the USSR to purchase equipment in the United Kingdom from a variety of suppliers. A minimum contract value is agreed upon for utilization of the credit line and contracts must be placed by a certain date. This usually applies for capital goods exports at a minimum value of about $25,000, although it is possible for a group of smaller contracts to qualify for the minimum.

The $2.3 billion ECGD facility pledged by Prime Minister Wilson in February 1975 illustrates the procedure whereby ECGD coverage is committed for lines of credit which are to be made available over a five-year period at a subsidized fixed rate of interest of 7.2% and with repayment over as many as 8½ years. The interest rates pledged by Wilson are higher than the 6% credits previously available to the USSR, but still below market rates. The first deal to be financed under the $2.3 billion ECGD facility apparently will be a $7 million order for spark-plug equipment. Lloyds Bank reportedly is now negotiating a credit with the Soviet Bank for Foreign Trade to finance the sale.

The United Kingdom routinely makes credits available to East European countries under the same general conditions as those for the USSR. In April 1975, for example, National Westminister Bank granted an ECGD-backed $47 million credit to Bank Handlowy w Warszawie for the purchase of UK capital equipment. To qualify under this line of credit, a contract must range from roughly $120 thousand to about $5 million and be placed before March 1976. The terms are 4-5 years repayment at 6 to 8½% depending on terms provided by competitor countries.

Japan

Soviet and East European capital goods imports from Japan are normally financed by long-term, low-interest supplier's credits. Under the Japanese export financing system the exporter's commercial bank applies to Japan's Export-Import bank (Eximbank) for financial assistance. The final loan consists of a blend of low-interest Eximbank funds and commercial funds loaned at market rates. Eximbank usually provides 60% to 80% of the contract price.

Japan's Eximbank is supervised by the Ministry of Finance and is supported by government funding and special borrowing privileges. While commercial and political risk insurance -- available from the Ministry of International Trade and Industry -- is not required by law for Eximbank participation, it is usually demanded in practice.

For several years the USSR had unsuccessfully pressured the Japanese government to provide credits directly to the Soviet Bank for Foreign Trade. Finally in April 1974, the Japanese government (via Eximbank) agreed to permit buyers credits for the USSR and an agreement was signed between Eximbank and the Soviet Bank for Foreign Trade providing long-term financing at 6.375% interest for $1,050 million in Japanese exports.

In April 1975 Soviet pressure led to a second buyers credit to cover the sale of $223 million in ammonia plants. The exact terms are still not available, but Eximbank will reportedly provide 10 year credits at 7.5% interest for 70% of the purchase price.

The Japanese have also provided trade financing on a buyers credit basis to Eastern Europe. In April 1975, for example, Romania received a $80 million buyers credit to cover purchases associated with the port development at Constanza. The 8 1/2 year credits carry an interest rate of 7.5%.