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UN - ECA PROJECT

TRIANGLE TRADE AND COOPERATION

**A Feasibility Study on
Linking the Economic Reconstruction of
Eastern Europe with
African Development Strategies**

Vienna, Austria, July 1992

**United Nations
Economic Commission for Africa**

UNICON

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CONSULTING & INSURANCES GMBH

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PREFACE

This report was elaborated by Mag. Johannes Halapier, Managing Director, UNICON Consulting Co., Vienna, and by Dr. Jumber Assatiany, Consultant to UNICON, Moscow and Tbilisi, on the basis of a personal consultancy contract with the UN Economic Commission for Africa.

In the East European countries, there has been a considerable echo to the work for this study. The managers of the East European firms we visited, welcomed the idea of the project, for instance the Bulgarian Television presented the project. Also the financing institutions we visited showed much interest; our interlocutors in the EC praised the "practice- oriented, pragmatic and selective approach by the ECA".

Within our company we have worked for many years in Eastern Europe as consultants for West and East European companies and organizations. None the less it was a great pleasure and brought us new experience to work for this study. We want to thank the Economic Commission for Africa for this possibility.

We also want to thank some friends and persons for their valuable contributions to this project:

Mr. Franz Granitz, UNICON, for his perfect preparation of our visits in Bulgaria, Hungary, Romania and for his collaboration in the whole project.

Mag. Karla Braun, UNICON, for the current handling of project organisation

Dr. Michael Stefanov, SOFIA, for his support of our project in Bulgaria and

Dr. Manuel Pincheira, MOSCOW, for additional valuable contacts with Russian firms.

PREFACE FROM ECA

After the disintegration of the USSR and the introduction of democracy into the former communist countries, Western European countries and America are directing most of their financial flows to the transitional economies of Eastern Europe in order to promote their development and consolidate the liberalization process of the economic structures of these countries.

However, the former communist countries are facing a severe liquidity crisis especially at the level of production units, precipitated by a severe decrease in turnover and profit due to the collapse of the CMEA market. There have been efforts to compensate the loss of the CMEA market by trying to gain access to Western markets, but these efforts have had little success. Some of their products although of good quality, still do not meet Western standard. Massive investments are needed before European requirements can be attained.

Most firms currently face the severe problem of underutilization of installed capacity. In 1991 trade between individual states and other members of the former CMEA market declined by 50 - 80 per cent. For example, trade between the former Soviet Union with other CMEA countries dropped by 52 per cent regarding exports and by 58 per cent, regarding imports. It appears, therefore, that the economic growth of the former communist countries will depend not only on investment flows but also finding outlets for their products, in other words, promoting their exports.

Two ECA consultants respectively from Austria and Russia have visited more than 100 important enterprises in Russia, Bulgaria, Romania, Czechoslovaquia, Hungary, Slovenia and Croatia. They studied the experience of these East European firms and their readiness for cooperation with African entrepreneurs, based on mutual interest. Their main conclusion was that many of the

products of these countries are relevant to African countries. Minitractors, pumps, building materials, transportation equipment, helicopters, aircraft especially for cargo transport, fertilizers and insecticides, refrigeration chambers, air conditioners, household refrigerators and freezers, construction machinery and equipment, medical equipment, pharmaceutics, structural steel for the construction for industrial building, reservoirs, railway cars, mining equipment, transport trucks, etc.

Evidently, for Eastern European economies to restore growth they have to accelerate economic transformation and development and regain their creditworthiness. They will only achieve this objective if they are able to trade with other regions of the world including AFRICA.

The East European countries have expressed interest in some African raw materials such as coffee, cocoa and tropical fruits. As for cocoa and coffee, for example, it might be possible to process these agricultural raw materials into finished products by setting up joint ventures including African producers, East European Consumers and European firms who possess the necessary technology for the production of instant coffee and chocolates. The opening of large markets in the Eastern countries can have a positive impact on trends of the prices of these agricultural raw materials. The participation of African producers as shareholders in the processing of these raw materials will constitute an important factor for the negotiation of just prices for those products. This must be the first concrete step for African producers of agricultural raw materials before regaining control of the prices of these products.

Triangular Trade and Economic Cooperation between Eastern Europe and Africa, and Western Europe shows clear mutual interests for the three parties concerned. Indeed, discussions with the European Bank for Reconstruction and development have indicated

that the Bank will be interested in financially supporting any profitable investment scheme between Eastern European, African, and EC countries. East European countries are not only willing to sell their products to African countries but they are also interested in going into joint ventures with African partners as well as with partners from EEC countries who could provide management and credit facilities.

Bankable projects could be developed based on the fact that products coming from eastern bidders are priced considerably lower than world market prices. It must be pointed out also that for products such as agricultural machinery, construction of medium and heavy trucks, steel products specially steel for construction, mining equipment and machinery, chemical fertilizers, medical equipment etc. Many of these East European products are of high standard and are competitive with Western European products. The prices of those products are sometimes up to 50 per cent lower than world market prices.

If properly managed, they can boost the development of many African countries because they would open up new economic opportunities and because they are robust and convenient for the stage of development of the African economies. Of immediate interest would be intermediate technology, products such as steel for construction, cement, chemical fertilizers, pharmaceutics.

INTRODUCTION

The present report is the result of an intensive grappling with problems of the economic reconstruction of the former communist states of Europe. The tasks which these countries are facing are historic and new. Standard models for the transition from the controlled economy to market economy do not exist. Many new ways have to be proved in practice, and sometimes new challanges have to be courageously met.

What is valid for the national economies, is also valid for the enterprises.

The East European enterprises have to create new and sound enterprise structures as a base for the privatization of firms. Of course, these new enterprise and management structures require new market strategies which have to be oriented towards the quickly and dynamically developing European Market and to the ever more integrating World Market.

The starting point

The East European enterprises, their products, their problems, their capacity and the market strategies of their managers were the practice - oriented and empiric starting point of this study. It has been the aim of this study to ease the economic approach of Eastern Europe and Africa. For this purpose, we did not establish a list of propositions for global solutions, but we tried - by the means of visiting numerous enterprises in Russia, Bulgaria, Romania Czechoslovaquia, Hungary, Slovenia and Croatia - to find products and services which could be interesting for Africa.

We tried as well to explore the experience of these East European firms and their readiness for cooperation with African firms. A cooperation in a sense of mutual interchange of products, but also in the context of new, sometimes completely unconventional, models which are both necessary and possible due the new and as unconventional global economic situation.

Some important parameters have decisive influence on this situation and were starting points for our reflexions:

The severe crisis in all former communist countries caused by the break down of the CMEA market, severe liquidity crisis of many firms, turnover and profit loss of enterprises in the former CMEA market, a certain but not sufficient compensation of these losses by the switch to Western markets, high need of investment financing which, however cannot be covered in local currencies due to the high inflation rates, partly rich experience with African markets, but also here strong market losses and the desire to regain markets. Finally, too little know how in the field of international

investment financing and too little know how and techniques in the fields of trade financing and marketing. From the point of view of the firms visited by us, the access to new markets in an offensive way and with high product quality is linked to many serious problems.

Global Visions of a New Europe

The decisive and global parameter is that the developed European countries cannot permit the formation of a deep economic gap right through Europe if their goal is the global integration of Europe. The politicians are aware of this problem and therefore we can observe a huge (although not sufficient in spite of the impressing amounts) capital mobilisation towards Eastern Europe.

Selective Capital Mobilisation

This capital mobilisation concentrates on the promotion of economic sturctures like small and medium sized enterprises, on the privatization of government owned firms, on the reorganization of these firms, on human resources management and, of course, on the support of local currencies. This capital mobilisation is combined with a series of subsidies, which are conceded in a selective and project-linked way. These subsidies offer many possibilities for developing efficient trade and project cooperations with foreign partners in a way that also motivates the foreign partner who can benefit from subsidised funds and other kinds of support.

A main question of this study was:

Which models can be developed in order to make African firms participate in the capital mobilisation towards Eastern Europe with a positive and long-term effect for both partners. We got to the conclusion that such cooperations are feasible but they require a careful and responsible project set up from both sides.

Eastern Europe is Ready

In Eastern Europe there is much willingness not only to export to Africa, but also to buy African products or to cooperate on both markets.

Out of a great number of feasible cooperation possibilities, in this study we have described those models, which are typical and not theoretic, i.e. schemes conceivable for East European managers but which also require and make possible new, complex financing schemes.

Therefore we had exhaustive talks with private banks (European commercial and investment banks), with financing institutions (World Bank, IFC, European Bank for

Reconstruction and Development), as well as with representatives of the European Community in order to find out which financing possibilities exist for such projects.

New Financing Instruments

Depending on the objectives and statutes of these institutions the financial policy varies. The general tenor in all cases was that the main problem is the development of economically effective projects. There is no lack of financing, but a lack of well prepared and well defined projects. Well prepared and well defined projects must be bankable projects, i.e. they must not only justify the need of financing but also prove the rentability of the project.

The Triangle Options

This very often requires management know how, which makes the cooperation with West Eruopean corporations necessary. It is easier to finance projects based on this know how.

A basic rule for European financing is that best cooperation projects are those in which a West European Partner participates with products or services, i.e. a triangle construction. This is valid, above all, for the whole complex financing instruments of the European export promotion systems (buyer credits, supplier credits, guarantees, export insurance systems).

Of course an East European enterprise that wants to export to Africa cannot apply for an European buyer credit for his African partner - but this is possible when the export operation is carried out together with a European partner who introduces part of his product in the final product and who contributes services.

Conditions for project cooperations are similar. The EC, but also the European Bank in London are ready to finance joint ventures registered in Eastern Europe (e.g. between an East European and an African firm). It is even possible that the first operations are financed with a short-term operating credit by the EC.

A basic rule - and this is one of the main conclusions of this study - is, that the possibilities for an effective trade and project financing are best, when a West European partner is involved in the project or transaction. Western management and engineering know how also increases the possibilities of obtaining internationally financed credits.

Structure of the Report

The present report gives, in its first part, a ***review of the economies of the East European countries,*** in its second part it gives a ***review of the international capital mobilisation towards Eastern Europe*** and finally an ***assessment of the attitude and procedures of the financing institutions*** regarding the goal of our project, which is to develop and stimulate adequate cooperations and transactions.

These analysis are followed by a series of ***selective models for economic cooperation between Eastern Europe, Africa and Western Europe***. These models are not theoretic, but they are a result of many conversations held with many representatives of firms, financial institutions, etc., as well as a result of personal experience. The models have been developed in view of their practicability, and within the scope of this study they are, of course, only some examples of existing possibilities.

The schematic representation of cooperation and transaction schemes is followed by a ***survey of products*** which we selected from innumerable possibilities, because of their quality, their competitive prices, and because of the willingness of their producers to cooperate with African partners within the scope of the proposed model structures. The description of these products can, of course, not be exhaustive and detailed, it is only intended to represent different product lines.

In this study we tried to show possibilities for cooperation which are adequate for the new economic dynamism. We did, of course, not make new inventions. We merely tried to integrate existing possibilities and structures into a proper mosaic, in order to promote the approach of the East European, African, and West European economies in a pragmatic way - i.e. direct cooperation from firm to firm.

A little step further can be taken, if this study is followed by concrete actions. It was also our intention to show that even for very difficult economic situations there can be specific solutions, and to create some economic optimism. If we succeeded in conveying these ideas to some of the readers, we have achieved our goal.

CONTENTS

The Economic Development in Eastern Europe in the Past Year: Increased Economic Crisis and First Signs of Recovery

The development in the former CMEA countries defer considerably. Nevertheless, they have many symptoms in common: deep and global crisis in 1991, partial intensifying of the crisis - but also a partial light recovery in 1992. Hyperinflatory developments in some countries, relative stabilization success in the currency policy of others.

The Economic Performance in 1991

As a reaction to internal and external shocks, in the past year the economic performance in the former CMEA countries (not including the former GDR) decreased from quarter to quarter.

In Hungary, CSFR, Poland, Bulgaria, Romania, the former Yugoslavia and the former Soviet Union, the production, i.e. the industrial turnover, decreased 7% after the first quarter , 8 % after the second quarter and almost 10 % after three quarters, compared to the same periods of 1990 . The decline was relatively slight in the former Soviet Union.

The worst decrease was registered in Bulgaria and in CSFR. At the beginning of the year, the governments of both countries forced the transition to market economy. Apart from the former Soviet Union, Poland registered the slightest decrease of still considerable 12 %.

Dynamic Development of the Private Sector - but Poor Effect on the Overall Economic Performance

After the decline of industrial production of approx. 25 % in 1990, a slight growth had been expected.

Although the private sector is not completely included in the reports, in spite of its dynamic development, its effect on the overall economic performance could not be very important due to its low share in industrial production.

Therefore the crisis in the former socialist countries assumed proportions unknown in these regions since the depression years from 1929 to 1933.

➢ **Besides special factors like the war between the former Yugoslav republics, there are four main reasons for this crisis:**

- *Contionuous breakdown of communication streams and production correlations due to the disintegration of the former central planification and control*
- *structural distortions and lack of balance as a result of decades of planned economy:*

  Especially the liberalization of pricing (in Poland since 1990, in Hungary partly even earlier, in CSFR and Bulgaria at the beginning of 1991) contributed to a decrease of production because the market prices did not cover any more the production costs and at the same time subventions were reduced.

- *The policy of overall demand limitation (import restrictions, high taxes) was especially severe in Poland, CSFR und Bulgaria*
- *The transition to world market prices and to convertible currencies in the trade between the former CMEA countries lead to a collapse of trade.*

The Collapse of Markets

The trade relations between the former CMEA countries broke down due to the fast transition to netting with convertible currencies.

The average trade decline of 50 % - 60 % led for some companies to an up to 80 % order decline.

By this development the structural problems became evident inmediately:

➢ ONE- SIDED ORENTATION TOWARDS THE CMEA-MARKET

The production of most of the countries in Eastern Europe was orieted towards the CMEA internal demand, especially towards the market of the former Soviet Union. The result were enormous production capacities. With a decrease of turnover of more than 50 %, the production capacities were under-utilized. This lead to an increase of inflexible expenses which soon were not financiable any more.

There have been efforts to compensate the collapse of the CMEA markets by trying to enter Western markets, but these efforts had little success. The reasons:

The product profiles barely corresponded to the western demand, in many cases a qualitiy improvement was necessary. In order to meet the higher requirements, many companies had to raise loans for investment but also for financing their current costs. These credits became much dearer because of the rapid inflation (for instance approx. 40 % interests in Hungary and Bulgaria). The companies got into liquidity crisis before they achieved to gain new market positions.

➢ TOO LITTLE PRODUCTIVITY IN PRODUCTION

The governmental enterprises have in common too high manpower as well as unprofitable cost structures. Together with partly obsolete technology these factors lead to a low productivity level and as a result of it to low rentability or even deficit ridden production.

➢ MONOPOLIZED FOREIGN TRADE

A second reason was the monopoly of foreign trade held by the governmental foreign trade companies within the planned economy.

With the reorientation towards free market structures, most of the monopolies fell and most of the governmental foreign trade companies were dissolved or restructured. The other companies were entitled to realize foreign trade on their own. The problem was the lack of know how. The companies had no experience in international marketing, in foreign trade financing, in risk prevention and other important skills.

All the above mentioned countries registered a decline in foreign trade. Especially the former Soviet Union, Bulgaria, Romania but also CSFR suffered a tremendous decrease, especially of imports but also, although less important, of exports. Only Poland and Hungary increased their imports.

The trade of the former Soviet Union with the former CMEA countries dropped 52 % reagarding exports and 58 % regarding imports. Based on real prices this decline was even worse.

In the trade with western countries only the three advanced reformer countries Poland, Hungary and CSFR could increase exports. After three quarters the exports to the West had nominally (in US dollars) increased 24% in Hungary, 19% in Poland and 11 % in CSFR.

The other countries, especially Bulgaria, report a drastic decline of imports from and exports to the West. In total ,however, the trade balance of the whole region with the West improved mainly due to the reduction of soviet imports (62%) while the total export reduction was of "only" 25 %.

➢ INCREASED UNEMPLOYMENT, BUT NO MASS UNEMPLOYMENT

Compared to the decline of demand and production, until now the unemployment has remained relatively low. This makes a difference to the crisis in the depression years from 1929 to 1933.

The number of unemployed in Central and Eastern Europe rose to 4.9 million persons until the end of September - that means that it was 2

million higher than at the end of 1991 (only in the third quarter it was increased by 900.000).

Nevertheless the decline of employment was not as fast as the decrease of production. The overemployment in the national companies - typical for the controlled economy - partly even increased, the labour productivity decreased correspondingly.

As the nominal wages expanded at the same time (still less than the prices), the labour costs per unit of production rose. Generally we can state that the labor productivity decreased faster than the real wages. This lead to an additional cost burden which- together with other cost factors like high credit interests and devaluation of currencies - made a successful fight against inflation impossible.

➢ INFLATION

The lowest *inflation rates* were registered in CSFR and Hungary. Only Poland reported a reduction of inflation compared to the previous year.

The highest *price increase* compared to 1990 was reported in Bulgaria and Romania. In both countries prices were only released in 1991, in Bulgaria at the beginning of the year, in Romania not before July. In Romania some important food prices were frozen again after miners' riots.

Generally we can state that the character of the inflationary process changes. On the one hand the repressed inflation becomes an open inflation, on the other hand demand factors lose their importance while cost factors are of greater weight.

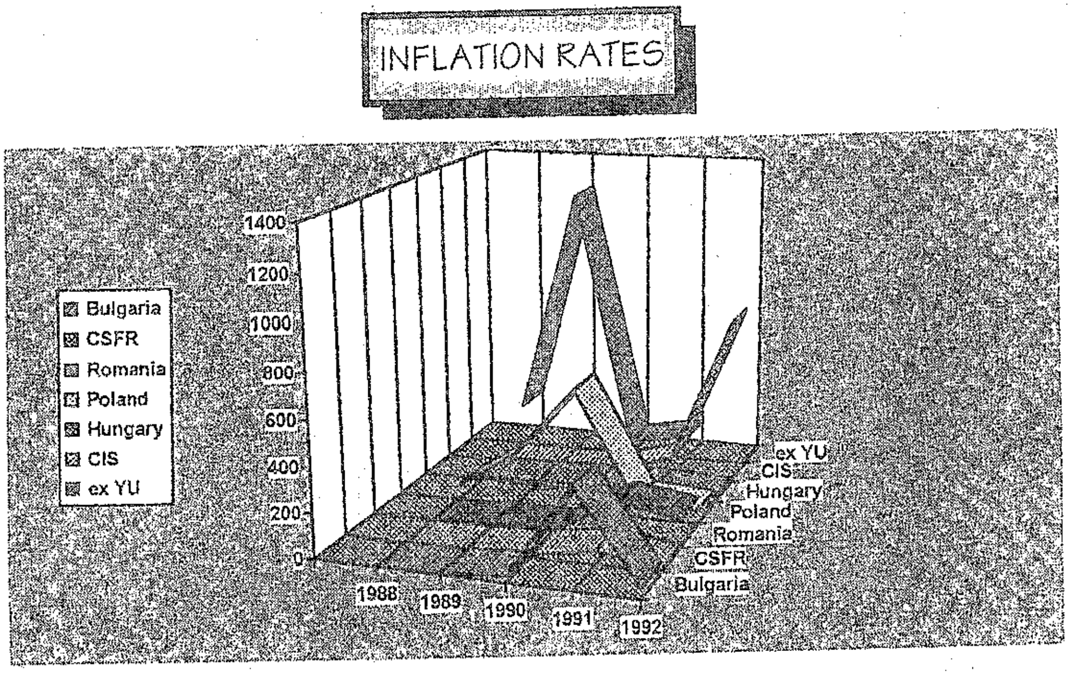
This phenomenon could be observed in Poland since the beginning of 1990 and in CSFR and Bulgaria in the course of 1991.

The liberalization of prices first lead to a very important increase of the monthly inflation rate which subsequently decreased due to a drop of demand. The remaining inflation level of approx. 1,5 to 5 % per month is mainly a consequence of important cost factors, especially the rising labor costs per unit of production and it will hardly be possible to reduce it by macroeconomic limitations of demand.

The performance of the fourth quarter of 1991will not show a stabilization of the development in any of the countries. That means that the industrial production in the whole year 1991 will have decreased 18% in Central

and Eastern Europe, almost 20 % in former Yugoslavia and between 8% and 10 % in the former Soviet Union.

The gross domestic product (GDP) of Central- and Eastern Europe will have registered an estimated reduction of 13% to 15 %, that of former Yugoslavia of 25 % and that of the former Soviet Union of 13% to 15 % compared to 1990. That means an estimated decrease of the gross national product (GNP) of 18 % in the course of two years.



	1988	1989	1990	1991	1992
Bulgaria	2,4	6,4	26,3	435,0	45,0
CSFR	0,1	1,3	10,1	57,9	10,0
Romania	2,6	8,4	7,4	167,9	125,3
Poland	60,0	247,0	558,3	75,8	60,0
Hungary	15,3	17,9	27,7	35,0	27,0
CIS	0,5	2,0	5,3	91,0	750,0
ex Yugosla-via	194,1	1240,0	601,0	107,5	

Source: National Statistics, Vienna Institute for Comparative Economic Studies

Graphics: UNICON

SOME COUNTRY RESULTS IN DETAIL

The policy of "shock therapy"

The discussion on the methods of the economic reforms and on the rhytm of transition led to different opinions, ranging from modest "step by step" programmes to radical reforms. For the moment it seems that too much hesitating policies caused a loss of time and pushed the economies into even deeper crisis and a big number of companies into bankrupcy.

The more radical way became known as "shock therapy" in Poland. The main features of this "therapy", which means a stabilisation programme, were a reduction of budget expenditure, to be achieved above all through the slashing of subsidies, a restrictive monetary policy to dampen demand, coupled with an often almost-complete price liberalisation, as well as the full opening of the markets; hand in hand with the latter step went the introduction of a (limited) convertibility of the currency (the so-called "internal convertibility").

In addition to this economic programme, sweeping changes occurred in the social and legal systems - not only in the institutional sphere, notably in connection with monetary and fiscal reforms.

The following pages will give a short view on some country results of economic performance.

THE FORMER SOVIET UNION

The former ***Soviet Union*** *- in this context comprising the CIS republics - is also among those countries of the former CMEA in which the stabilisation policy, but also in that a law of property and a company law were introduced, and the whole issue of privatisation was tackled. Russia did not take the "shock therapy" way but tried to introduce soft reforms. The success is not yet to be foreseeable.*

As a result of the Munich Summit the G7 countries agreed on US$ 24bn financial assistance for Russia that will be provided in stages through the IMF, the industrialised countries and through debt rescheduling.

The G7 leaders pressed Russia and the republics to adopt sound economic politics: Russia promised to sharply cut deficit (to 5 % net of all foreign assistance or loans, by end of December) and inflation (to 9-10 % monthly) and to go on quicker with privatization.

The goal to make the rouble a convertible currency was not realistic from the beginning. Now we have to wait and see to what extent the government will achieve to put into practice the anti inflation measures agreed on with the IMF. Amongst others, this will be an important factor for the decision of the IMF whether to release further tranches of the promised financial aid.

➢ *RUSSIA*

In **RUSSIA**, the largest and economically most important CIS state, apart from inner ethnic conflicts (some of the more than 100 nations in 16 autonomous republics, five autonomous regions and ten autonomous districts have formed highly separatist movements) and the growing strength of traditional communist- and extreme russian-nationalist movements, social unrest is imminent.

The food supply is partly very bad; according to the Labour Secretary, at the beginning of the year, 80 to 90 % of the population lived under conditions below poverty level. At the beginning of February, part of the reform program had to be revoked due to strong pressure by Jelzin-critics and the population.

The number of price-regulated goods increased, the IVA for some food stuffs was lowered from 28 % to 15 % and completely abolished for

canteen food (which lead to a reduction of government receipts of 25 to 30 bn. roubles).

Payments for the retired, scholarships and public servants were considerably increased (additional costs of 15 bn roubles) in order to compensate the price increases.

The Russian economy still faces a severe recession. In 1991 the GNP fell 11 %, the agricultural production 4 %; in the first four months of 1992 according to official forecasts, the overall output will be 19 % lower than in the same period of the previous year. Until October there will be an estimate number of 8 million unemployed.

Still the Russian economy is by far the leading among the states of the former Soviet Union. Russia obtained three fifths of the total output, in industrial production its share was two thirds, in agriculture 46 %.

Especially in the energy sector the still dominant role of Russia is evident: 90 % of soviet oil, 77 % of soviet natural gas, 63 % of electricity and 55 % of cole are produced in this country. Nevertheless, in the past year for instance the oil production decreased considerably. In 1991 it was of approx. 400 million tons, in 1992 it will be of only approx. 360 million tons.

☐ Interdependence Between CIS States

In spite of its dominant position also Russia is still integrated in the system of interregional and now interstate dependence on agricultural and industrial production (for instance in the textile sector, which strongly depends on the cotton imports from the central asiatic countries).

This means that Russia still depends on maintaining trade relations with other states of the former Soviet Union. Its most important advantage in this constellation is the application of world market prices in foreign trade (as well within the CIS republics).

☐ Privatization

In 1992, the privatization initiated by the government will be put into practice in the small enterprises of food and light industry, in most of the companies in the sectors of trade and service , transportation and

construction. About one fourth of the enterprises' shares will be distributed among the employees.

There will be limitations for the privatization of enterprises with more than 1000 employees; communications installations, arms industry, banks, natural ressources and social institutions will remain governmental domains.

The future of pharmaceutical industry, mining and hotel industry as well as the privatization mode for real estate has not yet been definitively decided on. In exportation many goods are subject to a quota regime, in some fields government licences are required for imports and exports, in the food and electric energy sectors only for exports.

BULGARIA

In Bulgaria this "shock therapy" not only led to a fall in GDP by roughly one-fourth but also to a surge in unemployment, from 0 % to 11 % at end-1991. Prices rose about fivefold, which caused real wages to plummet by one-half or so.

Foreign trade expressed in current US dollars shrank to about one-half of the already modest pre-therapy volume (exports: - 54 %, imports: - 64 %). In this global economic setting hardly any progress was achieved in the solution of the debt problem, which has been pending since the moratorium was declared in 1990.

In the trade balance there is still an asset of 420 million dollars and a current account of 1.3 bn dollars.

➢ Relative Monetary Stabilization

In the last twelve months,Bulgaria managed to achieve sort of a macroeconomic and monetary stabilization. The IMF and the World Bank supported the reorganization. The fall down of economy could not be completely stopped in 1991, the buttom seems not to be reached yet. The GDP decreased 23 % to 11,5 million Lewa (compared to a 11,8 % reduction in 1990), the industrial production dropped 27%. Agriculture got into a deep crisis, for the present year prospects are not any better.

➢ Foreign exchange debt

The most serious problem for Bulgaria is its foreign exchange debt of approx. 12 bn.dollars (approx. 400 % of the GDP or 1.330 dollars per inhabitant). Almost two bn. dollars of this debt could be rescheduled to western government credits by the Paris Club. The problem of credits financed by commercial banks(approx. 10 bn. dollars) has not yet been solved, there has not been an agreement on their extinction in the London Club.

The international financial aid for 1991 was of only 470 million dollars by the IMF, 150 million by the World Bank, 200 million by the EC and G-24 countries (further 200 million have been promised by the EC, 400 million by other countries). With these funds Bulgaria could not even cover half of its financial requirements estimated for 1991 (1.6 bn. dolllars). End of

1991 Bulgaria had foreign currency reserves of scarce 300 million dollars, its gold holdings were of approx. 305 million dollars.

Within the scope of the economic reforms the fight against inflation was successful. Inflation could be reduced from 573 % (from December 1990 to December 1991) to 3 %- 5 % monthly. The supply situation returned to normal.

The real income losses (approx. 60 %) naturally caused discontent, but they didn't lead to any serious labor disputes. In December 1991 the average wages were scarce 1000 Lewa (approx. 100 dollars), the unemployment rate was 10 %; in 1992 it will be 15 %.

The budget deficit of 8.5 million lewa (about 6 % of GDP) was higher than the amount agreed on with the IMF. Also for the present year there is little hope to find possibilities for deficit limitation.

➢ Convertibility

The internal convertibility has been successfully introduced, foreign trade currency transfers are not subject to any restrictions. The Lewa recently showed tendencies of devaluation. The Bulgarian National Bank wants to maintain for the moment the restrictive monetary and credit policy, the discount rate is 54 %. A cautious easing in order to stimulate the economy could soon be a political neccessity if a stagflation shall be avoided.

A new inversion law adopted in January offers liberal conditions to foreign investors. Foreign trade has been completely liberalised (except for some sensitive products) and a harmonised tax system has been introduced.

➢ Dynamic Development of Private Economy

In the private economy (0,5 % of industrial production, 4 % of overall economy) 180.000 new companies have been set up, 35.000 are interested in foreign trade.

ROMANIA

In Romania the stabilisation policy, which had been introduced in 1991, produced still poor results, parts of it even had to be reversed. The stabilisation measures led to an increase in prices and a consequential loss in purchasing power, but the supply of goods improved hardly at all.

Unemployment, on which statistical records started to be kept in March 1991, reached 337,000 at year-end, which represented about 5 % of industrial employment.

The attempt of reaching "interal convertibility" by means of an exchange rate, fixed on 11 November 1991, of 180 Lei for 1 US dollar, failed; already two months later measures had to be taken which hem "internal convertibility" considerably: export licensing and foreign exchange rationing.

In spite of incomplete internal convertibility, there is a 100 % guarantee for transferring enterprise profits abroad.

➢ Privatization

The privatization law intends a three-step-plan: conversion of government owned enterprises into commercial companies. 30 % of the share capital will be transferred to 5 private owners' funds, the remaining 70 % will first be kept by a governmental owner's fund and later on these shares will be reduced step by step.

CZECHOSLOVAKIA

To Czechoslovakia the first year of reform, which also implied a "shock therapy", brought a considerably steeper decline in GDP (-14 %) than expected, while the structural changes failed to materialise to the desired extent.

Agricultural output receded by merely 9 construction posted a 33 % fall, and transport plummeted by as much as 36 %. This decline can be explained only in part by the collapse of the former intra-CMEA trade. The forced contraction of domestic demand, one of the goals of the shock therapy, has produced much more drastic results than had been intended by the economic-policy makers.

Industrial production is continuing on its downhill course, reporting in December a 38 % decline (in nominal terms) from the comparable 1990 level. The average decrease for 1991 as a whole was 23 %, and this rate even includes the estimates for the new private enterprises.

The most severely affected sectors were clothing, electrical appliances, textiles and leather, as well as the non-ferrous metallurgical sector, with the contraction in output ranging from 35 % to 42 %. Hence the disproportionately small reduction in industrial employment by "a mere" 12 % implies a further decline in labour productivity.

➢ Unemployment

Whereas the cut in industrial employment is yet to come, the whole-economy unemployment rate was as much as 6.6 % at year-end 1991, compared to 1 % in 1990. Primarily due to structural differences, Slovakia is hit hardest, with an unemployment level of nearly 12 %. To make matters worse, only little more than one-half of those reported jobless receive support payments.

The rate of inflation, which had been 10 % in 1990, averaged 58 % for 1991 as a whole; in December 1991 the annualised rate was 54 %. Nearly half of this surge must be attributed to the liberalisation of prices launched in January 1991; for the ensuing months only single-digit rates were registered. To prevent a wage-price spiral, incomes were raised at a slower pace, which caused real wages to slump by 15 % - 20 % in 1991.

➢ Privatization

In 1991, the first year of the so-called "small privatisation", 22,300 business establishments passed into private ownership, through auctions, sales or restitution to their former owners. These privatisations yielded a budget revenue of CSK 25 billion (about US$ 840 million).

Following the submission of concrete privatisation projects of the individual enterprises last year and their current examination by the relevant ministries, the first wave of the "large privatisation" started in May and shall - according to plans - be completed by August.

Of the total assets to be put up for sale, valued at CSK 440 billion (US$ 15 billion), roughly 60 % are likely to be offered during the first wave.

The so-called voucher privatisation is still going through a preliminary round. So far 8.5 million Czechs and Slovaks have acquired vouchers at CSK 1,000 (US$ 34) each. The vouchers may then be entrusted to investment funds, numbering over 400, or invested directly in the individual enterprises earmarked for privatisation. The actual value of the vouchers will be evident at the earliest in 1993, when the new companies issue their first balance sheets.

Since the medium to long-term outlook for the economy is strongly dependent on modernisation to be accomplished with the help of foreign investment, a considerable stimulus is hoped to be provided by the "large privatisation", as this scheme allows for the participation of foreign enterprises, either through some kind of combination with the voucher method or through a complete sale to foreigners.

Last year approx. US$ 700 million worth of foreign funds flowed into the Czechoslovak economy, with a strong concentration on the Czech lands. For 1992 a volume of over US$ 1 billion is forecast to pour into the country.

The 1991 budget closed with a slight deficit of CSK 18,6 billion (US$ 626 million), which corresponds to 1 % of GDP. Although subsidies have been slashed, the previous surplus was eaten away by mounting social expenditure, plunging tax revenue from enterprises due to a slump in output and growing indebtedness, and, above all, by the budget deficits of the Czech and Slovak republics.

Due to the new political situation (separation of the Czech Republik and Slovakia), the predictions for this year's economic development differ

enormously. The forecast of Czechoslovakia's central statistical office is a margin of - 3 % to - 10 %.

Hungary

In 1991 the Hungarian economy was marked by inverse trends. First, the country's external position improved further, while the domestic recession was deeper than originally expected. Second, the emerging private sector, especially the newly established small and medium-sized businesses, displayed a remarkable dynamism, whereas the output of the state enterprises continued to decrease.

The 1991 current account closed with a far better result than had been predicted a year before. While the original forecast had anticipated a deficit of about US$ 1.2 billion, Hungary can boast a US$ 400 million surplus. This success was mainly due to two factors: the actual energy prices were considerably below the forecasts, and, Hungary coped with the breakdown of intra-CMEA trade much better than originally assumed thanks to stepped- up exports to the West.

➢ **Successful in shifting exports to western markets**

In 1991 Hungarian exports to western industrial countries rose by about 56 % which implied an increase in their share in total exports from 65 % to 77 %. Accordingly, exports to the ex-Comecon region fell by about 12 %, their share in total exports thus receding from 35 % to 23 %. It is surprising that the exports to the West were increased in spite of the real appreciation of the forint in the course of the year.

The forint was devalued as late as November to enhance the price competitiveness of Hungarian exports in western markets. The current account surplus was also attributable to the favourable result of the services sector, notably tourism - net revenue from tourism was about twice as high as expected - but also by a considerable inflow of capital, stemming from the so-called "official creditors", i. e. the IMF and the World Bank, and from foreign direct investment.

The latter reached US$ 1.5 billion in 1991, an impressive change against the level of US$ 340 million recorded in 1990. The current account surplus and the influx of foreign capital led to a steep upturn in Hungary's monetary reserves, from US$ 1.1 billion in 1990 to nearly US$ 4 billion at the end of 1991.

➢ Improvement of foreign debt situation

Thus the improvement, registered for several years, in significant foreign-debt indicators such as the debt service ratio, continued. By the way, never before - not even in times of economic hardship - has Hungary given rise to concerns as to the punctual fulfilment of its debt obligations, nor has Hungary ever applied for a rescheduling. All these factors certainly contributed to Hungary's successful return to the international capital markets. Recently an international banking syndicate arranged a loan in the amount ofDM 600 million for the National Bank of Hungary.

➢ Recession of domestic economy but dynamic development of the private sector

In contrast to the successes achieved in the external economy, the recession of the domestic economy aggravated last year. According to preliminary data, real GDP last year slumped by about 7 % to 8 The main reason was the poor performance of Hungary's industry, which fell by 15 %, not least in consequence of the structural adjustment process.

The large state owned enterprises keep reducing their activities, and, what is more, are increasingly affected by the collapse of Hungary's traditional export markets.

It is possible, though, that the decline in industrial output is not so dramatic after all because the official statistics have not yet taken the expanding sector of small and medium-sized enterprises sufficiently into account. Unlike the official statistics, according to which the share of these private-sector businesses in total industrial production is about 4 % to 5 %, independently prepared statistics show this proportion to be about 10 % to 12 %.

➢ Unemployment

Private consumption, too, reflected a rather sluggish performance in 1991, owing to a decline in real incomes and rising unemployment. At the end of 1991 the number of persons out of work was approximately 400,000, representing an unemployment rate of roughly 8 %. However, there are strong regional differences. For example, in Budapest the unemployment rate was about 1.5 %, an indication that jobs are created faster in new small and medium-sized enterprises in the capital than elsewhere in the country.

➢ Inflation

Inflation picked up at the start of 1991 as a consequence of the abolition of certain subsidies, liberalised food prices, rising governmental fees and higher indirect taxes. In the second half of the year the price uptrend lost momentum thanks to the real appreciation of the forint, increased competition brought on by the progressing liberalisation of imports, and wage settlements that were below the inflation rate.

However, in 1991 inflation averaged 35 %, which was slightly higher than in 1990.

➢ Strong rise of foreign investment, development of banking system

The success of Hungary's economic policy and the progress made in structural reform mirrors not least the vigorous rise in foreign direct investment.

After the steps implemented last year, the liberalisation of prices and foreign trade is almost complete. In addition, early in December 1991 the new central bank law and the new law on financial institutions entered into force. Both laws together constitute the second big step of Hungary's banking reform.

At the start of 1987 the first fundamental reform, the establishment of a two-tier banking system, had been enacted.

The new banking law regulates, inter alia, the privatisation of the Hungarian banks, planned to be carried out in 1992, as well as the activities of foreign banks. The new central bank law ensures to the National Bank of Hungary a far- reaching independence from the government.

➢ Privatization

Some successes have been achieved in the complicated task of privatizing state-run enterprises. Since the establishment of the State Property Agency in 1990 about 500 of the 2,500 state-owned enterprises have reportedly been privatised, and restructuring measures are said to have been initiated at more than 700 enterprises.

➢ Outlook

In 1991 the maintenance of external solvency played a significant role. In 1992 economic policy is likely to focus on fighting inflation. For example, the new President of the National Bank of Hungary, Mr Peter Akos Bod, names the struggle against inflation, together with the preparation of the full convertibility of the forint, as the main tasks facing the National Bank this year.

The government, optimistically, hopes to push inflation down to about 20 % to 25 % in 1992. A downturn is indeed conceivable - perhaps not quite this size - as a number of factors responsible for the price uptrend in 1991 have meanwhile disappeared.

In all, the opposing trends which influenced Hungary's economy already in 1991 are likely to persist throughout 1992, albeit less visibly. The domestic recession should ease, the government and the National Bank are even expecting a real economic growth of up to 3 % for 1992. As already in 1991, the state sector's decline in output and employ- ment is to be increasingly countered by the newly established and briskly expanding small and medium-sized enterprises.

Domestic demand is likely to remain subdued because private consumption will hardly pick up, given the downward trend of private households' incomes, while investment is unlikely to take off as yet.

The question is to what degree these dampening factors can be offset by rising demand from abroad. In fact, Ne the dynamic development of exports is expected to continue. Especially exports to the western industrialised countries should benefit from the association agreement concluded with the EC and taking effect since 1 March 1992.

Exports are also likely to be stimulated by the joint ventures entered into with western partners, which by now are estimated to total 10,000 or so. Although the economic upswing and the restructuring process of the Hungarian economy point towards a steep rise in imports too, the current account should be at least in equilibrium at the end of 1992, provided the recently reported successes in tourism are followed up.

In any case, in Central and Eastern Europe Hungary will remain the leader in the transformation of a centrally planned to a market economy. What is more, Hungary may be the first of the reforming countries of the region to overcome the adjustment-induced recession and to start on a growth path, although this will be moderate at first.

Poland

According to official statistics, 1991 ended with no sign of economic growth. Two years after the anti-inflationary programme was initiated by former Finance Minister Balcerowicz GDP declined by 8 %, industrial output fell by 14 %, the budget deficit stood at US$ 2.8 billion, and inflation at 60 %.

The absence of economic growth was due to several factors, namely the breakdown in trade with the former USSR and CMEA, depressed domestic demand, the difficulty in pushing through structural reform measures (such as privatisation of the loss-making state sector), and lastly, a cut in government revenues, while government expenditures were increasing at the same time.

➢ **Fast developing private sector**

It is important to stress that the official statistics do not paint the complete picture. Private sector output in Poland has increased dramatically, and the majority of this is not yet captured in the official figures. While the output of state companies fell by 19.5 % in 1991, private companies were able to increase their output by 25.4 %, giving them a 24 % share in total production. This compares with a share of 17.4 % in 1990 and 10 % in 1989, and is very strong evidence of the sector's dynamic growth.

➢ **Reorientation of Foreign Trade**

With the collapse of CMEA trade, Polish exports to the region have fallen by 56 % since 1989, and imports have diminished by a similar magnitude. In particular the breakdown of the former Soviet Union has adversely affected the Polish economy. Barter agreements with the former Soviet Union began in the summer of 1991 and cover an increasing share of trade, indicating that the worst may have been over at year-end 1991. In February 1992 Poland signed a deal to buy 5 million tonnes of oil from Russia (partly by barter), exchanging this for food, medicine, sulphur and coal.

The reorientation of foreign trade towards the West began in 1989, and by 1991 the EC accounted for 53.3 % of Polish exports. However, this

"success" was relative because foreign trade activity has slowed down, with exports suffering more than imports.

Even when taking into consideration an unfavourable exchange rate, Polish exports in 1991 held out well, remaining virtually unchanged after 41 % growth in 1990, while imports increased by 42 %.

➢ State companies: Still in problems

The worsening situation of the state sector has remained a problem. Unable to market their products, most firms could not meet payments by mid-1991.

Part of the problem can be attributed to the inability of state firms to produce efficiently. Instead of cutting costs, reducing employment and seeking new markets, they simply raised prices with the as- sumption that the government would soon bail them out. Managers worked closely with state councils and trade unions and tended to maximise wages and employment rather than profits. Privatisation of state enterprises has proceeded slowly, and significant management changes have failed to take place.

➢ Hyperinflation stopped

However, in the two years of the Balcerowicz programme Poland did make astounding progress, succeeding in its immediate goal of stopping hyperinflation. Prices moved into line with world market prices, the output of the informal sector (not captured in official statistics) surged, queues disappeared. The population, however, was not satisfied: unemployment stood at 12 %, and consumer goods, though available, were expensive.

Following the policy intended to improve export competitiveness and reduce imports, the zloty was devalued by 12 % against a basket of 5 Western currencies on 25 February 1992.

The last major devaluation took place in May 1991, when the National Bank of Poland devalued the zloty by 14.4 % against the same basket, followed by a crawling peg that continued devaluation by approxi- mately 1.8 % a month since October 1991. The original target of the Balcerowicz plan was that inflation would be in the single digits by 1991. It is now believed that this goal may be achieved by 1994 and inflation will be reduced to 40 % in 1992.

IMF: Suspension of loan disbursement

The IMF suspended the disbursement of an extended loan facility in August 1991 because Poland failed to reach targets that had been mutually established for the budget deficit. Poland's budget deficit for 1991 was US$ 2.8 billion or seven times the agreed amount. The new government hopes to lower this figure to 5 % of GDP by raising turnover taxes on tobacco, patrol and luxury items. The government also hopes to raise company profits, increase budget revenues and stem the threat of mass bankruptcies through lowering wage costs, increasing exports and reducing import competition.

Privatization

Mass privatization is a clear priority and Western managed funds will carry out the programme. The aim is to transfer half of all Polish industry to the private sector within two years, with shares in 200 firms sold to the population at a nominal charge. Poland has been very successful in privatising trade and retail outlets, with nearly 80 % of small shops privatised since 1989.

SLOVENIA: THE EXCEPTION

On January 15, 1992 Slovenia was recognised by a large number of countries as an independent state and thus welcomed into the international community. In the economic sphere Slovenia is giving top priority to changing to a market economy as quickly as possible.

➢ Economic situation

With a population of 1.9 million (about 8% of the total population of former Yugoslavia) Slovenia was the most developed of the Yugoslav republics. It thus contributed 18% to the country's social product in 1990 and accounted for 20% of Yugoslavia's industrial output. The public sector accounted for about 83% of Slovenian social product, and was therefore by far the most significant force in Slovenia's economic structure. According to estimates social product per capita in 1990 was about US$ 5,300, a figure comparable to those for Greece or Portu- gal. Per capita social product for Yugoslavia as a whole stood at $ 2,200, while in the country's poorest region, the province of Kosovo, it amounted to $ 500.

➢ Economic performance in 1991

Apart from feeling the deep economic crisis experienced by Yugoslavia, Slovenia also suffered from war damages that occurred in the right for independence, which are put at US$ 2.7 billion.

In 1991 social product (at constant prices) declined by approximately 13%, in Yugoslavia as a whole this figure was as much as 20%. In Slovenia industrial production shrank by 2.4% and the number of un- employed rose steeply as a result of the decline in economic performance. The number of registered unemployed persons doubled with- in one year to 91,100, representing an unemployment rate of 11.4%.

According to provisional estimates of the Slovenian government exports of goods (measured in US$) fell by 2.5% in 1991, while imports de- clined by 10%. The trade deficit will thus amount to about US$ 240 million in 1991. According to official prognoses Slovenian social product will decline further by 6.5% in 1992.

Slovenia needs financial and technical support from abroad to cope with the problems of the transition to a market economy. In this connec- tion Slovenia's membership in the International Monetary Fund - and the IMF stand-by credit it would then receive - play a crucial role. Involvement by the World Bank is also necessary to bridge the finan- cial bottleneck, as Slovenia could then win other lenders of capital such as the Club of Paris or commercial banks.

➢ **Industry**

Industry accounts for about 43% of the Slovenian social product. Measured by the value of the goods produced and the number of persons employed, electrical machinery and appliances, metalworking, textiles and the construction of heavy machinery represent the most significant industrial sectors.

The economic significance of Slovenia for what was once Yugoslavia is reflected in the fact that it produced two-thirds of all Yugoslav household appliances, heaters, small electric motors, electric motorcar equipment and electronic telephone components.

About 25% of the output of the electrical industry is exported. The most important companies in this sector are **Gorenje** and the **Iskra** electronics group. Gorenje has so far sold 60% of its products abroad, mainly in Germany, France, Austria and Great Britain.

➢ **Agriculture**

Agriculture accounts for 5.1 % of the Slovenian social product. Two-thirds of the 870,000 hectares of the land in Slovenia that is under cultivation is grassland, while arable land accounts for 29%. Although 69% of the land under cultivation is farmed privately, the average size of private farms was only three hectares.

➢ **Unemployment**

Slovenia, like all other states of the economy-reforming countries, is now also confronted with the problem of open unemployment. At the end of December 1991 the number of persons employed in the public sector of the economy fell to 675,850, a decline of approximately 76,000 persons or 10% over year-end 1990. The number of registered unemployed rose

to 91,100 by year-end 1991, which corresponded to an unemployment rate of 11.4%. At the end of 1992 and the beginning of 1993, with 150,000 per- sons out of work, unemployment will assume serious proportions. It is planned to create 150,000 to 200,000 new jobs by 1995 with the help of foreign investment.

➢ Foreign trade

In 1990 Slovenia accounted for about 25% of all Yugoslav imports and 29% of exports. Trade with industrialised countries made up the bulk of both exports (73%) and imports (81 %). About two-thirds of Slovenian exports went to EC and EFTA countries. Slovenia's most im- portant trading partners in the European Community are Germany, Italy and France. Among the EFTA states Austria was the most important trad- ing partner, and in 1990 it was Slovenia's fifth most important trading partner overall.

About 21 % of Slovenian exports went to the countries of Eastern Eu- rope, and these states accounted for not more than about 13% of Slovenian imports.

Compared with the other Yugoslav republics only a small portion of Slovenian trade was transacted on the basis of clearing agreements in 1990 (13% of exports, 6% of imports). Among the countries with which Slovenia traded on a clearing basis the former Soviet Union was the most important trading partner.

Slovenia maintains close economic ties with Austria: in 1990 Austria imported goods from Slovenia valued at 2.8 billion Austrian schillings, and Austrian goods exported to Slovenia amounted to 4.2 billion schillings. Slovenia accounted for 53% of Austrian trade with Yugoslavia.

Among the branches most actively involved are banking and insurance, construction, and primary products.

➢ Privatization and foreign investment

The Republic of Slovenia has in the recent two years been confronted with three major challenges:

- ☐ **rebuilding of a democratic political system**
- ☐ **national independence and secession from the Yugoslav federation**
- ☐ **transition from a "self-management" socialist system with limited market exposure to a fully fledged market economy**

Of the three objectives of the new democratic government the third target has proved to be the most difficult one to achieve. Slovenia was the largest exporter to the western countries (*exports are almost 3 times of that of Bulgaria*), considered to be the shop window of the former socialist world, but on its transformation route it has, nevertheless, encountered severe problems of depressed industrial production, increasing unemployment and high inflation.

This was due not only to the political turmoil in Yugoslavia, where Slovenia had substantial traditional markets, but, to a considerable extent, to the declaration of Slovenia's monetary independence last year. The market transformation and privatisation came in that respect at the worst possible time.

➢ Opportunities

Restructuring and privatisation of socially owned enterprises along with the rapid growth of private business present an opportunity for profitable investment in the years to come.

Many economists believe the Slovenian economy has already hit the bottom of the recession (due to political and monetary break up with Yugoslavia) and is now on the recovery route. By joining UN and international monetary organisations (expected by the end of this year) Slovenia positions itself for high growth over the next five to ten years, building on its comparative advantages.

Slovenia is close to major Western European markets, not only geographically and logistically but also in terms of adopting western business culture including commercial flexibility, standards of business conduct and focus on customers' satisfaction.

Through the years of strong exposure to competition on the international markets, many Slovenian companies have developed a long-term relationship and trust with major western companies. This gives Slovenia an edge over other Central and Eastern European countries.

Slovenia has a highly skilled and committed, though only modestly paid workforce. This represents an advantage especially in labour intensive industries, because labour productivity in physical terms does not significantly lag behind Western European countries.

In comparison with other Central and Eastern European countries, Slovenian productivity is the highest.

The problem of a small domestic market has been largely overcome through establishing free trade agreements in the territory of former Yugoslavia, consisting of Slovenia, Croatia, Bosnia and Herzegovina and Macedonia. It is to expect that political changes in Serbia and Montenegro will enable the two to participate in the "Yugoslav common market" as well.

While still not being completely up to western standards, the infrastructure (railway, roads, air, telecommunications, housing stock) is one of the major advantages compared to other competing countries.

Prospects for 1992

For Hungary, Poland and Czechoslovakia - and of course for Slovenia - the economic prospects are surely better than for the rest of the reforming countries of the region.

A positive impact is likely to result from the agreement reached with the EC regarding the reduction of tariff barriers having taken effect on 1 March 1992. It contains, among other stipulations, an "a asymmetric" tariff reduction, i.e. an arrangement favouring the reforming countries, and holds out the possibility of an EC entry for all three countries.

Both in Hungary and in Poland the major institutional reforms have been devised and are being energetically implemented. With a certain amount of optimism it may be assumed that the economic "zero" is over and for 1992 a phase of stabilization can be expexted. This might (not for 1992 but for the following years) also be true to a certain extent for Bulgaria - given the debt problems can be settled. Romania and Albania will face continuing crisis and the increasingly realistic danger to decline from a second-world to third world status.

The crisis afflicting the CIS republics will deepen. Its impact will be fully felt this year, the recently promised relief measures (US 24 billion) will not materially alleviate the crisis. However, this support can help to ease the political tensions to some degree and thus give the region the chance of a fairly orderly transition.

➢ Stabilisation policy contra growth: necessity of an integrated structural approach

As far as stabilisation policy is concerned it must be noted that it is opposed to a policy of growth.

All experience gathered so far shows that stabilisation alone does not lead to higher profitability and greater profits, which stimulate investment and this, in turn, generates prosperity and economic growth.

On the contrary, we know from experience that idle capacities bite into the budget. Hence the aim of improving the budget on the expenditure side via a reduction or even abolition of subsidies is missed, while revenue shrinks drastically owing to the decline in taxes paid. On the expenditure side itself the goal of a budget improvement is often thwarted: for example, by the necessary unemployment benefits.

The altered causes of the budget deficit are evident in the case of Poland, where GDP, which had slumped by 20 % in 1990, again dropped by 7 % - 10 % in 1991. The resulting revenue shortfall of 15 % of the estimate thus led to a budget deficit of roughly 12.5 % of GDP.

➢ The state enterprises: liquidity crisis, low productivity, low profitability

Today the East European reforming countries have a mixture of private, state and traditionally state-owned enterprises.

Owing to the previously discussed economic environment many of them operate at a loss. Nonetheless, there has not been spate of bankruptcies or close-downs, for at least two reasons:

a) The rapid expansion of claims between enterprises

The stringent curb of credit prompted many enterprises to delay their mutual payments, which was a source of working capital for them. However, this method allows access to credit also to enterprises which are not economically viable.

b) The creditors see little sense in forcing enterprises into bankruptcy

The amount of money lenders can hope to recover depends on the value of the residual assets, which is extremely modest in the reforming economies, due to the absence of any real owners or shareholders. Today still, on account of the high concentration, the failure of an enterprise often means that the existence of the only customer or supplier of other enterprises is endangered, which may have fatal consequences for the entire produc- tion process.

The sorry financial state of the enterprises, the revenue shortfall and declining purchasing power were bound to affect demand and thus industrial output.

Although all reforming countries suffered severe setbacks in foreign trade, the region's trade balance and the current accounts were a lot better than had been feared at the start of the year.

What is more, in Bulgaria, Czechoslovakia and the ex-USSR the decline in imports greatly improved the balance of trade and the current account. The ex-USSR even managed to achieve a current account surplus of US$ 6.7 billion in 1991, while Hungary and Czechoslovakia reported a balanced current account.

➢ Indebtedness to be managed

The indebtedness of the reforming countries rose only marginally in 1991 and is likely to total now US$ 158 billion in gross terms.

Poland, Bulgaria and the ex-USSR were unable to meet their debt service. Bulgaria, which had to declare a moratorium in 1990, was unable to conclude a rescheduling agreement in 1991 for the settlement of its US$ 12 billion outstanding debt.

Germany was the first country to reduce its claims on Poland in compliance with the Paris Club agreement. Subsequently Poland reached agreements with the USA, Finland and the Netherlands, covering a total of US$ 1.7 billion. In addition, exchange rate fluctuations brought a further reduction in the outstanding dollar-denominated debt by US$ 2.1 billion.

CONCLUSIONS

Taking a view - based on the prior analysis - of the overall economic situation of the reformer countries in Eastern Europe, the situation does not seem to be very positive. But appearances are deceptive. The unpleasant goes along with the sensational. This means new opportunities for future developments.

➢ Reason for Euphoria or Concern?

In fact the most important economic indicators give us no reason to be euphoric when the situation is seen as a static one. But looking at the development of the last years, there is enough reason for a realistic optimism. This optimism must, of course, differ from the first euphoria which was awakened in view of the opening of new markets.

As we all experienced, in this euphoria it was not possible to realize how difficult the transition to market economy would be. This lead to frustration and of a result of it - at the beginning - foreign commitment and inversions in the region were much lower than expected.

➢ Structural Problems Require a Structural Policy

Let us not go further into the question whether some Eastern European countries were too slow at starting reforms. Probaybly this was the case - especially in the former USSR, in Romania and Bulgaria. But also the radical reformer countries (especially Poland) could not achieve immediate success. The reason was less the concrete reform policy than the very structure.

Only last year it became evident to what an outrageous extent the communist economic system had distroyed structures in each of the countries. Macroeconomic structures were distroyed as well as structures within the enterprises. Structures have been distroyed in the working persons themselves for whom terms like rentability, individual decisions, responsibility and productivity had become strange concepts with a mere theoretic meaning.

Considering these immense problems, the imminent relative stabilization (even though it is only a slowdown of the recession) means already a big success. A success which has been achieved at the expense of many sacrifices and which has to be appreciated. This success should be estimated strategically and not from an every-day-politics point of view.

One thing has become evident. A pure austerity-policy does not create a sound economy. Austerity policy is a must (compromises have only deferred problems) but it has to go along with a structural policy: a quick, carefully directed privatization should be combined with the simultaneous reorganization of enterprises, support for small and medium sized business, human ressources policy (training) and the creation of legal conditions favourable to investment.

➢ SPECIAL FEATURES OF THE EASTERN EUROPEAN MARKETS

For a foreign newcomer not only a realistic estimate of the macro- and microeconomic problems which were faced by the new democracies is relevant. A realistic asessment of the special features of these economies is as important.

WHO IS THE RIGHT COOPERATION PARTNER?

In the entire region of former CMEA today new rules are valid. These rules are far from being unified.

The majority of almost all the larger enterprises are government owned - or they are in a process of privatization. This has been done with many mistakes. "Privatization" has often been considered as a formal problem and has therefore lead to discussions and disputes about the future ownership structure. Much too little emphasis has been put on the main problem of privatization, i.e. the restructuring of enterprises. Only sound enterprises can be privatized successfully.

The question whether the management considers the formal side or whether it is oriented towards the future market - and this means a market adequate restructuring in line with market conditions - is one of the important criteria for the appraisal of an Eastern European cooperation partner.

Efficient restructurings require of course an adequate economic policy framework, a consolida- tion of accounts, and, of course, an organizational restructur ing of the whole enterprise.

An adequate economic policy framework is given if economic policy measures are pursued which promote the formation and accumulation of capital, stimulate savings, and make exporting easier. This means a balance of current- account-oriented exchange rate policy that implies a stabi lity-oriented monetary policy; a positive level of real interest rates, but not one that is too high; and an adequate, but not prohibitively high, tax on the profits of enterprises.

Further, it is important to clear the accounts of the enterprise, to reduce the debt burden of an enterprise to a manageable level, and to make the enterprise solvent again.

Enterprises in financial trouble need to be recapitalized one way or the other. Complete or partial debt relief may solve the problem. Sometimes it seems advisable if lenders convert the credits they have given to the enterprise into equity capital participation.

If such conversions of credits into equity participation take place on a large scale in the course of the privatisation of planned economies, the banks will very likely get into trouble eventually because they will be overburdened with equity shares in malfunctioning enterprises. The banks themselves, having no returns on their lending and on equity shares and not receiving any debt service, finally need to be recapitalized as well. In the economic crisis of the 1930s, several banks in Central Europe were nationalized when the state stepped in to recapitalize the banks.

Also for potential cooperation partners such privatization strategies are of interest: Many East European companies include into their cooperation offers restructuring concepts to be elaboreted commonly with the foreign investor .

The emerging private sector is less problematic: there is much readiness for innovation and flexible solutions. But also in this sector it is important to establish a base of confidence. One has to know one's partner. This requires a lot of time and experience.

THE COMMODITY MARKETS

It is very complicated to appraise the Eastern European commodity markets. We shall view some characteristics without going into the different economic sectors and branches.

➢ The Offers

The merchandises offered in the former CMEA countries consist in an intricate chaos of goods starting with low quality level, which are virtually unsaleable, goods of average level which are partly useful, up to goods of high tech quality. These high quality goods are mostly produced by enterprises with military production. Many of these enterprises are performing a conversion program in order to shift the production from armament to civil products.

In all production sectors there are extreme differences in quality. But there are interesting offers, like industrial raw materials, agricultural products (although the internal demand cannot be covered, many products are being exported), semi finished goods of heavy industry, intelligent finished products, especially in the field of mechanical engineering, but also of medical equipment.

➢ Export prices

An important factor for the competitiveness of East European products is their price. Other criteria are important as well: robustness, simple handling, quality of the processed basic materials - and often also precision.

The main criterion is still the price: one can proceed on the assumption that the export prices are10 % to 60 % below the world market prices (excepting prices of goods which list on the international commodity exchange).

The low prices are due to the rich deposits of raw materials in some countries (especially the former Soviet Union),the low labor costs and, of course, to the fact that the East European products are relatively unknown in international markets and still have to gain market positions.

Even though some enterprises tend to raise prices rather than lower the costs in the course of privatization, the East European products will still

be offered for a long time at prices much lower than (comparable) West European products.

Europe alredy got a taste of the Eastern competition. The inexpensive high quality steel products from the former USSR and Poland have made a strong downward pressure on prices, the cement produced in Eastern Europe (CSFR, Poland, former USSR) has glutted the markets and caused severe difficulties for some (also Austrian) cement producers. The same happened in the branches of raw aluminium and especially of scrap steel, where prices dropped dramatically in the past year.

In the fields of design and options many Eastern made goods are less sophisticated than Western products. But the relation of price-performance-benefit is decisive:
It may be a good choice to prefer an Eastern offer to a Western product when there is a good relation between benefit, price and amortization.

➢ DEMAND

The demand for goods, especially for consumer goods of all kinds, for perishable or long life goods as well as for food stuffs, for "normal" products and for luxury articles is enormous in East European markets. There is also demand for capital goods and for certain raw materials. Often the phenomenon of "empty" markets can be found.

The market potential is enormous. It should be clear that these markets can absolutely not be compared to developed Western markets: the financial resources - especially foreign currency - are not disposable in the necessary quantities to meet the demand, the communication between the seller and the potential buyer is established rather by accident than by the systematic development of offer and demand; distributio systems which we are used to in the West, only exist in an initial stage.

In spite of these difficulties, trade is developping rapidly. Nevertheless, foreign suppliers must develop creative strategies in order to gain a foothold in East European markets.

➢ Rudimentary Capital and Fianancial Markets in the Former CMEA

Although almost all former CMEA countries established or re-opened stock exchanges which had been paralyzed for decennies, capital markets are only in the process of development, especially in Hungary and Poland.

The development of capital markets depends strongly on the level of privatization and on the bank system. Hungary achieved already two years ago to make some enterprises negotiable (mainly with the help of Austrian banks). Thanks to the reform of corporate law - which has been adapted substantially to West European corporate law principles - in most of the other East European states it is now possible to buy shares in a commercial partnership.

Nontheless it will still take much time until a functioning capital market will exist. The same goes for financial markets. The domestic banks still have relatively little know how regarding financing instruments. Recently the first bond emission has taken place in Hungary; but still regular credits are the prevailing instrument, however problematic for the financing of firms: credit interests in national currencies have a spread between 40 and 50 %. (Example: The short term financing rate for banks is in Hungary 30%; interest rates for Forint-denominated medium-term investment loans amount to between 33% and 40%; saving deposits earn interest of between 25% and 30%, depending on the maturity period).

Like in all other former CMEA countries high interest rates have an adverse effect on the investment climate, along with the fact that earnings are weak at a great majority of state-owned copmpanies. Thus investment activity depends in a large part on the extent of foreign investment.

Foreign currency credits with low interests for domestic enterprises are only available to borrower who can present a project which absolutely guarantees repayment.

International Mobilisation of Capital for the Reconstruction of Eastern Europe

G7 and IMF Financial Assistance

The 24 bn US$ financial aid for Russia, which was agreed on at the recent Munich Summit and the subsequent release of the first tranche of 1 bn US$ was certainly the most evident sign for the West's strategical goal to make Eastern Europe a region with a functioning market economy.

The financial aid cannot solve the former Soviet Union's problems, but it can ease some of the negative symptoms of the crisis during the transition period. The financing should concentrate especially on the fields of food production, services and the improvement of communication systems.

For the stabilization of the rouble (its convertibility announced for July probably won't be put into practice that fast) a rouble fund to the amount of 6 bn US$ has been established. The most important part of this fund is financed by Western Europe, the United States contributed 25 % and Japan 12,5%.

This financial aid should not be seen separately. The IMF has taken part in the negotiations of a series of economic policy conditions. However, the conditions of balanced budgets and strict austerity will probably be applied less rigidly.

Apart from the G7 aid of 24 bn US$, the IMF expects that IMF loans for the CIS states will amount to 25 - 30 bn US$ in the next four to five years; furthermore, Russia claims write off of debts.

➢ Investment Terms for Eastern Europe

Aditionally, the G 7 countries have listed investment terms for Eastern Europe:

In May this year the trade ministers from the Group of Seven discussed actions needed from the countries of Eastern Europe and the former Soviet Union to attract foreign investment.
They also agreed that western economies must open their markets to imports from the former communist states.

The list of necessary measures included e.g. the legal protection of foreign investment and private property, reliable banking systems, clear rules on responsibility for environmental damage, and well-defined contract laws (East-West-Trade Summit in Münster).

Additionally to the mentioned G7 financial aid there is a number of bilateral assistance and agreements for the different East European reformer states. Austria, for instance, offered an open credit line to Russia in case that Russia is ready to release foreign exchange for unsecured claims by Austrian firms.

The US credit restrictions for Russia have been abolished, the US export bank increased credits for Russia considerably: 200 million US$ of export credits (credits for exports of US industrial products to Russia) have been already promised. According to bank director John Macomber, in the next 12 months the realized credits could amount to between 500 mn and 2 bn US$.

Recently the IMF accepted the economic reform program of Ukrainia and promised tighter colaboration. Until the end of the year, the new European Bank for Reconstruction and Development will allocate 5 to 6 bn US$ to former CMEA countries; in 1993 the credits will be considerably extended.

In April the IMF conceded a further credit of 322 mn. US$ to CSFR. Now the total debts of CSFR due to the IMF amount to 1.35 bn US$. This sum was released thanks to the consequently realized liberalization and stabilisation policy of CSFR: in the past year more than 90 % of prices were released and the government control was mainly abolished. Wage increases remained below the inflation rate (actually 58 %), the czech crown remained relatively stable.

Trade Agreements with the EC

In March 1st, this year, the European Communitiy´s trade liberalisation agreements with Poland, Czechoslowakia and Hungary have been settled, designed to give the countrie´s goods greater access to western markets.

Nevertheless independent comments state that the well financed and technically superior exporters from the west are likely to profit more quickly from the advantages of free trade than struggling industries in the former communist states.

Exporters from Czechoslovakia, like others from central and eastern Europe, have already made progress in gaining new market positions in the west over the past two years. Barriers are maintained on exports of key products such as steel, textiles, chemicals and glass, although they will be gradually lowered and removed altogether after 10 years. Curbs on sales of farm products into the EC's heavily protected agricultural market will remain in force.

Financial assistance by the World Bank

Besides other countries, recently the applications of the former USSR states for membership in the World Bank were adopted. According to World Bank Vice President Wilfried P. Thalwitz, the World Bank sees its task in the former USSR to intervene in such cases where the lack of foreign currency risks to interrupt production. Therefore the World Bank will concede Russia credit of at least 500 mn. US$ for imports of raw materials and intermediate goods.

At the end of October credits for structural projects in the fields of agriculture, industry and energy will follow. The interests for these commercial credits will be 0,5 % higher than the World Bank's cost of finance of actually about 8 %. In total the CIS states will receive World Bank credits amounting to 1,5 bn US$.

The repayment of the credits with a 17 years term starts after three years, which means relatively "soft" conditions.

End of 1994 the World Bank will be in conditions to spend yearly 4 to 5 bn dollars for the CIS states, half of which will be designed to Russia. The epansion of the volume of commercial credits is possible thanks to the last capital increase by the World Bank.

The CIS republics will receive a 5 % share in the capital stock of the World Bank, Russia's share will be of 2,9 %. 90 % of the total of 540 mn dollars "entrance fee" have to be paid in local currency, 10 % in dollars.

An additional agreement was settled between Germany and Russia allowing the resumption of Hermes export credit guarantees on German exports. In bilateral discussions the Russian economics minister assured that Russia would give govern- mental counter-guarantees for Hermes-backed trade, the absence of which has effectively blocked new contracts for German exports since the collapse of the Soviet Union.

The agreement means that guarantees from Hermes, Bonn's leading export credit agency, can now be given up to a ceiling of DM5bn this year, although this level will be reviewed every three months. German exporters, above all those from former East Germany, have been badly hit by the absence of export credit insurance to Russia.

Marketing and Selling in Eastern Europe: "Everything is different - but everything goes!"

Western businessmen had to realize after the first (and soon frustrated) opening euphoria that the East European markets are different from the developed markets with market economy tradition.

Many miscalculated, had high acquisition costs, but never achieved the conclusion of a profitable transaction. Many gave up after the first failures.

Who stayed were the insiders, the managers with strategic goals and strategic know how - and - what is most important - with enough patience to create relations of confidence with the worried East European partners.

"Everything is different - but everything goes" are the winged words among East-insiders. And these words really do characterize the whole contradictory situation in Eastern markets.

Which are the main problems for a businessman in Eastern markets?

- "Negative" Phenomena?

When trade relations of many years stably based on confidence do not yet exist, business will be difficult. To address firms from one's desk, so to say to do business "by fax" will not lead to any success, apart from

flukes. The same goes for Western Markets. Here the approach by fax is quite usual - especially because standard proceedings are a matter of course (for instance in trade); but in the long run the creation of good business relations is mainly based on good personal contacts.

For Eastern markets this rule is inalterable: personal contacts and well developed confidence are a good starting point for each business.

- **Necessity of good personal contacts.**

  Unless the firm who wants to enter the Eastern market is a multinational enterprise with enough financial resources to run offices in Eastern Europe, personal contacts with East European partners who specifically work on the local market are a must.

- **Special local know how**

  The East European markets are very diverse. From town to town, from region to region, market conditions are completely different: be it the control of certain submarkets by local lobbies and groups which are sometimes hard to identify, different distribution infrastructures, different pricing or different consumer structures.

- **The Lack of a Systematic Distribution System**

  The communist planned economy established an arbitrary system of goods distribution instead of a naturally grown demand - offer- structure. As far as exported or imported products were concerned, the government owned firms had monopolised all transactions (only minimal parts of the foreign exchange earnings were passed on to the producers). An organic chain ***importer - wholesale - retail trade*** had not developed. On the other hand, all the government owned foreign trade firms were dissolved or restructured, or they went bankrupt leaving a big deficiency in trading know how and distribution systems.

Therefore a new bidder cannot (like in Western markets) channel his products in existing distribution structures, but he has to create - together with his partners - a customer base and the necessary distribution structures.

- **Missing storage and delivery facilities**

In many cases not only the distribution systems, but also the contact points for imports are missing: systematic "local ports" in towns for storage and further distribution of imported products similar to West European wholesales chains (like "METRO" and others), which are also contact points for retail traders,are very rare.

- **Missing Import Know How**

Not long ago, the government owned foreign trade firms had the monopoly of all foreign trade activities. Since the producing enterprises got full economic independence, they have tried to gain a foothold in foreign markets or to cooperate with foreign partners without the tutelage by the former foreign trade firms.This experience process is very important but it has taken too much time. In many cases the foreign trade managers of the enterprises (and also their "technical crew") lack the fundamental techniques of foreign trade (f.i. how to issue and handle a letter of credit).

- **Lacking Availability of Products**

Not always products (for instance for compensation) are available in the required quality, quantity and at the right time. Therefore performance hedging (performance bond or performance guarantees) is often necessary.

➢ Payment Difficulties

Foreign currency is not always available, it is rather scarce. As the Eastern countries hardly dispose of **export promotion systems** as they are known in Europe, and at the same time they have little know how of creative financing instruments, the barter trade is - in most of the cases - still the best alternative. Of course, the whole compensation circle has to be well prepared. Then there should not be any problems, because the East European countries - at least the former URSS - dispose of good products and of sufficient raw materials.

➢ Convertibility of Currencies, Transfer of Profits

The transfer of profits is generally admissible, also the problem of non convertibility of Eastern currencies is now less drastic than before. Recently, several finance techniques have been developed in order to be able to convert Eastern currencies into convertible currencies (US$ or DM).

Which Possibilities Do Eastern Markets Offer ?

East European Markets are Strategic Markets

With a population af about 400 million, the markets in Central and Eastern Europe are a huge strategic potential. The needs, especially the backlog demand, are enormous. In the former URSS only an estimated 10 % of the demand for bananas is covered, many persons have never in their lives seen a banana.

In the context of the economic recovery of the former CMEA countries, which can be expected over the mediate term, these markets will become huge demand - markets.

Hungary, Czechoslovakia and Poland have already made a clear statement of their intention to obtain the EC membership. This will of course take time, but the first steps towards a total integration of Europe have already been taken. The most diverse cooperation and trade treaties have introduced this process. At the same time, the West European states are fully conscious that only a unified Europe can be a guarantee for permanent stability and economic and social progress. The West European states feel deeply responsible for the reorganization of Europe. Their solidarity becomes evident with the great number of multilateral and bilateral aid measures for the reconstruction of East European economies.

The EC is already number one in world trade.Its external exports (excluding members' trade with each other) amounted to ECU 413 billion in 1989. This represented 15 % of world exports compa red with 12 % for the United States and , 9.1 % for Japan. The EC is the biggest market in the industrialized world, with a population of 340 million; it is also one of the most open markets.

The Community has to export in order to finance its substantial imports of food and raw materials. The EC is the world's biggest importer of agricultural products. The Community's exports consist of quality manufactured goods (80% of the total) and of processed foodstuffs.

With the imminent enlargement of the EC by some EFTA states (Austria, among others) the Common Market (the Single Market) will gain importance.

Especially for countries, whose main production and whose competitive strength is in the field of agriculture, the new Eastern markets are strategic markets and there is no alternative to the development of adequate strategies in order to gain a foothold in these markets.

The motto must be: "With the new East European markets stronger for the way towards the EC" or "with the EC stronger for the way towards Eastern markets"

The Eastern bidders have interesting products at prices considerably lower than world market

In certain product groups (for instance all kinds of agricultural machines, construction machines, medium and heavy trucks, steel products, rare metals, mining machines, artificial fertilizers, certain products of medical equipment, etc.) the Eastern products are competitive regarding their quality. Prices are considerably sometimes up tp 50 % lower, than world market prices,

Furthermore, many firms which had worked exclusively for military purposes, are now shifting their production programmes to civil products. These firms often dispose of high technology (for instance laser technology) as well as licenses, which opens the possibility of transferring high technology at considerably lower prices than Western technology.

The Former CMEA Markets: A Unique Possibility for Africa for Gaining Strategic Market Positions in Europe

Is the Common Market 1993 and the Approach of Estern Europe to the EC an Economic Threat to the North-South Cooperation?

On the occasion of the signing of the LOME IV Convention there were some worried commentaries about the new developments in Europe. Centre of attention was the question whether the EC and the other West European industrialized countries would concentrate their activities too much on Eastern Europe and thus "forget" the African countries.

For instance the Preisdent of Togo, Gnassingbe Eyadema made an appeal to the EC: *"not to abandon their friends of the South for the benefit of their brothers of the East whose opening to the Community market will basically change the fundamental element of North-South cooperation ".*

Also the realization of the Single European Market in 1993 is causing concern. Mr. Eyadema said:

"Europe, having become one economic and monetary entity, will encourage a prejudicial protectionism against nations of the southern hemi- sphere, while having closer ties with Eastern countries which constitute 'a more attractive market. "

This fear can be easily understood. If we take into account the volume of capital which has been transferred to Eastern Europe one could ask:

Where should additional capital for the South come from? The total amount agreed on in the LOME IV Convention is 12 bn. ECU (about 16 bn. US$), with 8 bn. grants. Only the financial aid recently approved for

Russia by the G 7 states is of 24 bn US$, the total help promised by Wetern donors pledged by governments and institutions is - only for the CIS states - of 86bn.US$. And - according to experts - this is only the beginning.

In spite of the comprehensible concern, we think that the new development is no threat to African producers. On the contrary, it offers new possibilities which were unthinkable two or three years ago.

➢ Triangle trade and cooperation schemes - an adequate strategy for better access to East European Markets

Regarding both imports from and exports to Eastern Europe, today there is a series of possibilities to optimally safeguard the African interests.

➢ The Triangle Principle - African Participation in the International Mobilisation of Capital Towards Eastern Europe

It is the imperfection of East European markets, their relative chaos and the not yet defined and developed market economy structures, today it is possible to get inconventional access to market shares which would be unthinkable in West European markets.

☐ **The principle: Tight cooperation defined by contracts between**

- *an African importer/exporter/producer*
- *an East European importer/exporter/producer*
- *a West European partner with specific know how on Eastern Europe*

The roles within this triangle can vary, according to the kind of transaction or project. Important is, that the definition of roles and the mutual relation meet the requirements linked to the support, credits, guaranties, grants and other market orientated assistance offered by the West in order to facilitate the access to Eastern markets.

➢ Our Experience in the Past Months

In the course of the preparation of this study we visited about 100 best East European firms and had innumerable conversations with representatives of chambers, of the new private sector and of the governmental privatization agencies: everywhere we found a high willingness to establish such triangle cooperation projects for the benefit of all parts. Many enterprises had African markets before which broke down due to different reasons. These enterprises want not only to regain the old markets, but hey are ready for completely new cooperation models like our triangle project.

➢ The Seven Advantages and Possibilities of the Triangle Model:

- ***Access to Western capital mobilised towards Eastern Europe, partly financing of the entering into Eastern markets with these funds***
- ***Access to undear Eastern products without the disadvantage of high markups by Western intermediaries***
- ***Better and cheaper access to high technology, especially in the field of the former military industry***
- ***Better access to Western technology combined with Eastern technology (partial use of Western technology in Eastern products)***
- ***Access to Western know how in marketing, especially to professional "East-Marketing" of experienced Western partners***
- ***Access to personal, individual and confidence-based contacts with East European partners***
- ***Development of professional trade transactions and professional project know how in the triangle Western Europe - Africa- Eastern Europe.***

The Specific Role of Austria

With its traditional trade relations with Eastern Europe, but also with its political tradition and due to its geopolitical situation, Austria, a neutral state with traditionally good relations to its East European neighbours, played an important and unique role as a link between West and East even before the reform process started.The fast process of political opening and the radical acceleration of the peaceful revolution in Eastern Europe was only possible thanks to the opening of the Austrian-Hungarian border.Thousands of GDR refugees could go from Hungary to the former GFD passing through Austria.

But even before this development Austrian firms were traditionally established in Eastern Europe. German, Italian, American Japanese and South-East Asiatic enterprises were greatful for the services and know how of the Austrian "East pioneers" and they still make use of them.

The Austrian capital, Vienna, is an intersection point between West and East, and has become a priviledged place and a point of departure for activities of the international business in Eastern Europe.

Not local patriotism (the authors of this study are an intercultural consulting team resident in Austria) but conviction leads us to the opinion that Austrian partners are especially suited for the Triangle Project. The missing EC membership (Austria will be a full EC member and a net payer in 1995) is no disadvantge. The Austrian neutrality has always been an advantage for its economic relations with Eastern Europe, and this neutrality can also be proven towards Africa: Austria has no colonial past.

Some numbers for illustration: Austria covers 2.200 of the total of 9.000 joint ventures registered in Hungary. Some more than half of the total capital invested in Hungary came from USA, followed by Austria and Germany in the third place.In Poland 3.208 out of 4.900 registered joint ventures were carried out with Austrian partners. Austria's part in joint ventures in the CIS states is 230 out of 3.400, in former Yougoslavia it is 770 out of 4.600, in CSFR 1.500 out of 5.500 and in Bulgaria 25 out of 100. In relation to its size Austria is a major power in East business (reference: APA, Ost Eco, 02 1992).

A Historic Possibility forAfrica: Accelerated Internationalization in Europe

In December 1989, on the occasion of the signing of the Lomé IV Convention, Mr. Michael Sefali, President of the ACP Council of Ministers outlined a crucial structrual problem of the African national economies:

The dependence on the fluctuations of the World Market commodity prices, above all the dramatic fall in commodity prices since 1980. Especially prices for agricultural products (for instance coffee, cocoa, and others) were hit by the price fall, without a possibility to compensate the losses in other export sectors.

An, of course, indispensable strategy (of political entities and international organizations) is the attempt to reach international terms of trade agreements in order to avoid or ease the dramatic effects of such price developments on the producers.

A political platform for these strategies are, for instance, the GATT negotiations, product related agreements on market access and pegging of prices (like the ACP - EC sugar agreement).

➢ From the Defensive to the Offensive: Move to the Micro

What these strategies have in common is their defensive character. It is of course necessary to negotiate future-oriented market access and pricing. But apart from this, the producers have to develop strategies which are appropriate to avoid the dependence on global terms of trade. Single and offensive master strategies instead of "Waiting for Godot - strategies" are a must.

➢ World Market Integration = Internationalization

In a market economy it is not possible to wait for political agreements - this could lead to bankrupcy. But it is possible for a raw material producer to make plans and investments according to the final production. This final production should take place directly in the consumer market. It is possible to integrate the proper raw material and the proper intermediate product into the proper final production right in the market.

This strategy of capital investment abroad, in the consumer markets, is called "internationalization". Especially for African agricultural products the situation in Eastern Europe is perfect for putting into practice such strategies.

➢ Eastern Europe: A Classical Investment Market

Eastern Europe is privatizing. Nowhere else in Europe the acquisition of firm shares is as low-priced as it is now in Eastern Europe. Nowhere else joint ventures and other forms of cooperation can be established in such a fast, uncomplicated and reasonably-priced way.

And this fact opens the way for gaining - *together with East European partners, Western know how and Western participation in financing* - strategic footholds in the market, which make it possible to direct an offensive market policy in both ways:

Towards the former CMEA and towards the EC. A market policy based on final products and with a considerably reduced dependence on price fluctuations in the commodity markets.

In the future, such strategies are a must. ***"The great competition between the systems of east and west is over, but the competition between efficient locations, efficient policies on trade, environment, labour market, energy and competition will increase further. We need to keep sufficiently in step internationally in the micro-economic and structural area in order to avoid distortions of competition"***, said Mr. Jürgen Möllemann, Germany's Economics Minister on the occasion of the Munich Economic Summit in July.

The substance of his speech: There should be global agreements, but the enterprises should not just wait for them. Inmediate decisions, inmediate actions by the enterprise are important. - **"Move to the micro".**

- *The guiding principle "move to the micro", could be modified for African producers into "move to Eastern Europe". In order to attain this target, the strategies presented by us in the "Triangle Schemes" are necessary. The feasability of these strategies has been investigated by us on the spot with a great number of East European enterprises who showed serious interest in such triangle cooperations.*

In the next chapter we shall give a review on the stand by possibilities of private and international financing institutions followed by the presentation of some product groups and triangle-models. But before we'd like to quote again Mr. Manuel Marin, Vice President of the European Comission. On the occasion of the last Lomé Convention he said:

> *"It would be wrong to imagine that any advance of European integration has inevitably to be a threat to the Third World".*

Mr. Lucien Pagni added in his comment *"From Lomé I to Lomé IV"* (The Courier no.120, March/April 1990):

> ***"Africa will not be granted its role and place in the new international balance. It and it alone will determine what they shall be with the success of its economic achievements and the quality of its social organisation. The alternatives are fundamental reform or decline".***

One of these mentioned fundamental reforms could be - in our opinion - not to wait passively for international agreements, but to internationalize on enterprise level in an intelligent and courageous way. Eastern Europe is waiting.

THE APPROACH OF THE INTERNATIONAL FINANCING INSTITUTIONS

The European Bank for Reconstruction and Development

At the bank´s first annual meeting in Budapest, in April this year, the role of the EBRD was critiziced by East Europeans. *"So far the role of EBRD in our part of the world has been no more than marginal"*, said Mr. Vaclav Klaus, Czechoslovakian finance minister.

Apart from the relatively low financing volume (which will be considerably increased according to recent comments) there has been a dispute about the future fundamental credit policy of the bank: Should the bank reinforce "development banking" or should it concentrate on "commercial banking" as it has done up to this moment.

The relatively low financing volume has been partly due to the fact that the EBRD, like any other commercial bank, finances only "acceptable projects" and that project identification is difficult in Eastern Europe. In view of he economic crisis in all East European countries many projects were considered too risky.

The idea of financing at a higher risk and with softer conditions was contributed to the annual meeting by Mr. Attali.

He proposed a restructuring facility containing a combination of soft loans and high risk equity, especially for financing the conversion of the ex USSR military industry. This initiative was resisted by the US and other shareholders of the bank. Mr. Theo Waigel, German finance minister and new chairman of the bank´s board of governers, is also representing the "comnmercial banking wing".

➢ Priority: Credits for the Private Sector on Commercial Terms

The EBRD statutes require the the majority of its lending (60 %) to go to the private sector on commercial terms, at market interest rates, thus keeping the guiduing aim of encouraging private enterprise. This access and policy will surely be the main bank policy for the next time, with maybe some exceptions (e.g. in the case of nuclear plants security).

➢ Triangle trade and cooperation projects

The EBRD has concentrated on the financing of investment projects without developing a proper financing instrument for trade. On the occasion of our visit to the bank, representatives of the EBRD stressed that the bank admitted the importance of trade for the overall economic upswing in Eastern Europe and that it considered the possibility of including trade financing in its range of activities. However, these deliberations are not yet concluded and there iso decision on this subject.

The bank appreciates and is always open to the idea of ***triangle cooperations*** like investment projects in Eastern Europe with the participation of African partners. Bankable project- feasabilities will be accepted or rejected within 90 days.

The general substance of our conversations in London was: The bank misses above all interesting and reasonable projects. It is ready to participate in projects even at a preparatory stage.

➢ TARGETS AND PROCEDURES OF THE EBRD

The Bank's objectives are to provide advice, loans, equity investment and debt guarantees to qualified applicants designed to:

- *foster the transition towards democracy and open market-oriented economies; and to promote private and entrepreneurial initiative in the countries of central and eastern Europe*

➢ Exclusivity:

- *The Bank lends and invests exclusively for projects or in vestment programmes in the countries of central and eastem Europe (Albania, Bulgaria, the Czech and Slovak Republics, Estonia, Hungary, Latvia, Lithuania, Poland, Romania, the USSR and formerYugoslavia).*

- *The Bank's mandate gives it a particular concern for the promotion of democratic institutions and human rights in its countries of o perations.*

- *The Bank is a unique combination of merchant bank and dev elopment bank. Not less than 60% of its funding will be directed either to:*

- ☐ **private sector enterprises, or to**
- ☐ **state-owned enterprises implementing a programme to achieve**

- *Not more than 40% will be directed to public infrastructure or other projects.*

- *The Bank's commitment to improving the environment is an integral part of the Bank's operations.*

The Bank provides funds according to sound banking and in vestment principles and within commercial decision-making time frames.

➢ OPERATIONS

The Bank commenced operations in April 1991 at its headquarters in London. Its two operations departments are Merchant Banking a nd Development Banking, each of which is staffed by professionals with specialist country, industry and transactional experience.

- *It carries out its funding of private or privatizable enterpri ses in the competitive sector through* ***Merchant Banking****, which include s within it the full range of private sector financing skills an d experience.*

- *It carries out its funding of physical and financial infrastructure projects through* ***Development Banking****, which includes within it the full range of development bank financing, economic, country and sectoral expertise.*

➢ TYPES OF PROJECTS

The Bank actively seeks projects which will contribute to:

- **Developing the private sector**
- **Implementing privatization of state-owned enterprises**
- **Encouraging direct foreign investment**
- **Creating and strengthening financial institutions**
- **Restructuring the industrial sector**
- **Creating a modem infrastructure for private sector development and transition to a market economy**
- **Promoting small and medium-size enterprise**
- **Improving the environment.**

➢ ASSESSMENT OF PROPOSALS

The Bank requires proposals submitted by private and privatizable enterprises to have strong sponsors/partners and credible busi ness plans which demonstrate:

- **Good products or services with sound market prospects**
- **Significant capital commitments by project sponsors**
- **Dependable technology**
- **Sound environmental management**
- **An improvement in competitiveness**
- **A high return on new investment**
- **Overall financial viability of the borrowing enterprise.**

FINANCIAL PRODUCTS OFFERED BY THE EBRD

The Bank offers a full range of funding on a market, rather th an on a subsidised or concessionary basis, including:

- ***Loans (secured/unsecured, subordinated, convertible or equity-linked) with a maximum final maturity of ten years for commercial enterpris es and of fifteen years for infrastructure projects***

- ***Equity***

- ***Guarantees and underwriting.***

The Bank does not issue guarantees for **export credits** nor undertake **insurance activities**. Loans are normally denominated in convertible currencies or currency units, and the Bank does not normally accept currency risk on repayment.

The Bank's loans to commercial enterprises, including those made to state-owned enterprises implementing a programme to achieve private ownership and control, are made **without government guarantees** and require a full commercial return which reflects the risks attached to them.

The Bank normally limits its financing to 35% of a commercial borrower's total capital. It aims to assist borrowers to obtain finance from other lenders and investors.

➢ Minimum size of funding:

It is normally not practical or cost-effective for the Bank to make loans or investments directly of less than an indicative minimum of ECU 5 million equivalent. Instead, the Bank will seek to make funds for smaller loans and investments available through local financial intermediaries. The Bank will direct borrowers seeking smaller loans or investments to these intermediaries.

➢ Terms

The Bank's rates of interest are based on a margin over a market benchmark (normally LIBOR). Loans can be at a variable rate or - using the swap market - at a fixed rate, with usual resetting features. The amount of the margin depends on the specific characteristics of the loan.

The Bank charges an upfront fee on agreement and a commitment fee on the undisbursed portion of its loans.

➢ Equity financing - Equity Investment

The Bank can provide equity financing where this is instrumental in enabling transactions to be completed which might not otherwise obtain financing. Its equity investments must give the Bank the prospect of recovering its financing in the medium term at a price which represents an adequate equity return on its investment.

The Bank will not take controlling interests nor assume direct responsibility for managing enterprises.

➢ Risk Insurance

In its financing operations, the Bank will require the companies or entities it funds to obtain adequate insurance coverage against normally insurable risks. It will not require protection against political risk or inconvertibility.

➢ CO-Financing

The terms of the Bank's funding are designed to enable it to cooperate both with International Financial Institutions and with a range of public and private financial institutions through co-financing arrangements.

➢ Mobilisation of additional funds

The Bank is able to mobilise additional commercial funds, either at the time of initial funding or, subsequently, from syndicates of private lenders by selling them participations in the Bank's loans.

Where banks participate in loans for which the Bank is the lender of record, they may share in the benefits of the Bank's protection.

Where banks participate with the Bank in this way at the time of initial funding, they can also do so on the basis that the portion of the loan funded by them has different terms and conditions from that funded by the Bank.

PROCEDURES

Requests for financing should be submitted directly to the Bank by the commercial enterprises seeking finance, or by intermediaries authorized to act on their behalf.

In processing funding proposals for submission to the Bank's Board, Merchant Banking relies on its professional valuation and credit structuring skills and its specialized knowledge of the countries of operations.

Its approach is commercial, involving a full assessment of project merits and a timely processing of credit decisions to the firm commitment stage; un der normal circumstances this should take two months from the receipt of ful l project information.

Merchant Banking will work closely with sponsors in reviewing the commercial merits of proposals submitted and the risks attached to them, taking into account the business plans available, as well as the Bank's agreed country strategy and the proposals' environmental implications. The Bank is able to provide advice on project structuring and financial design for investments in the region. The Bank enforces strict confidentiality.

DEVELOPMENT BANKING

➢ Proposals from central and local authorities, utilities, financial institutions and other public sector agencies:

Requests for financing should nominally be submitted directly to the Bank by the government or public authority sponsoring the project, rather than by individual contractors competing for such projects.

Proposals will be reviewed by Development Banking staff and considered in conjunction with the Bank's agreed country strategy. Specific proposals will be subject to a financial, economic, technical and environmental review to assess their viability before submission to the Board.

Development Banking can offer assistance in the following areas:

Advisory services
Project identification, preparation and funding in the physical and financial infrastructure sectors
Mobilization of additional finance from public and private sources on a co-financing basis
Support of project implementation., including procurement.

➢ International Tendering

Public projects normally require open international tendering procedures consistent with the Bank 's Procurement Policies and Rules' for procurement of the goods, works and services it finances. Under special circumstances the Bank would agree to other appropriate procedures such as selective tendering, single tenders and shopping in line with the Bank's Procurement Policies and Rules.

➢ Technical Assistance

In selected cases the Bank can offer financial advice, and training and technical assistance, where this facilitates the achievement of its overall objectives, based on funds specifically provided for this purpose by

certain governments and international institutions. The Bank does not seek advisory mandates for the purpose of earning fees in competition with providers of advisory services. It rather assists selected governmental or private sector entities in defining requirements for selecting, monitoring and financing consultants and other advisers.

THE EC APPROACH

GENERAL POLICIES TOWARDS EAST EUROPEAN INTEGRATION

The EC states that although the first generation trade and cooperation agreements lifted quotas and other quantitative restrictions on exports from the EC's East European partners, they did not contain any element of tariff preference to facilitate their access to the Community market. Nor did they provide for statutory financial aid.

But they were (and will be) the starting point for the second generation of association agreements or **'European agreements'**of a totally new kind. In the meantime a second generation of agreements has been already settled (March 1 agreement with Poland, Hungary and Czechoslovakia, liberalizing trade with the excpetion of some barriers for key products such as steel, textiles, chemicals and glass).

The agreements to come, so the official EC policy, would even go beyond the free-trade accords which the Community has forged with the individual countries of EFTA.

The association agreements are to consist of four essential elements:

(1) **free trade between the country concerned and the European Community**
(2) **industrial, technical and scientific cooperation**
(3) **a pluriannual programme of financial assistance**
(4) **the creation of a mechanism for political dialogue**

The agreements would constitute an end in themselves. They are not a transitional phase on the road to membership of the Community; neither do they exclude the possibility of an 'associated' country applying subsequently to join the EC.

➢ Free trade

The aim of the agreements is to bring about the phased introduction of two-way free trade. This step-by-step approach will take account of the specific reforms under way in each country as they concern prices, subsidies, taxation, monetary policy, currency convertibility and its

system of foreign trade. The aim of the reforms is to align their national systems with the open system of multilateral trade and global competition.

In moving towards the free-trade objective, the Community will reduce its tariff and other import barriers more rapidly than part ner countries. Associated countries would open their markets for Community goods according to a flexible timetable and one which reflects their specific situation.

Once the economies of the associated countries have succeeded in bringing themselves close to the level of the Community, negotiations can begin on the free movement of persons, services and capital. Their economic legislation could also be harmonized with that of the Community.

The economic and technical cooperation will reinforce the structural changes undertaken by the associated countries, contributing to their integration into the world trading system. Prime focus will be on measures to facilitate technology transfer and direct foreign investment.

Actual cooperation projects will cover areas such as professional training, the environment, the modernization of agriculture and of agro-industries, the renovation of industrial structures, science and research, energy, mining, transport, tourism and other services, telecommunications, health and medical equipment, standards and norms.

- **Financial assistance**

The Community will offer a set amount of credits for each associated country to finance cooperation and technical assistance. The Community is already committed to spending ECU 2 billion in assistance to Central Europe.

THE PHARE PROGRAMME

(Extract from EC papers "The Phare Programme")

The Phare programme was set up by the Group of Seven (G-7) summit in Paris in July 1989. The summit charged the European Commission with coordinating assistance from the Group of 24 Western industrialized countries taking part in the programme:

This function enabled the Commission to take on a new and important international political role. For, besides coordinating Western aid, it has increasingly taken the lead in framing Phare policy and strategy. The initial aims of Phare were to sustain the political and economic reform process in Poland and Hungary and in particular to strengthen the private sector. The priority areas identified by the Commission, in consultation with the IMF, the World Bank and the OECD, are now the object of substantial programmes.

> ***These areas are agriculture and rural development, enterprise restructuring, banking and finance, investment, the environment and professional training and technical assistance.***

In addition, the G-24 countries have taken action to facilitate access to Western markets for Polish and Hungarian exports. They have removed quantitative restrictions on Polish and Hungarian products, extended most-favoured nation status (where this was not already granted) and extended to them their system of generalized preferences (SGP).

In May 1990 the Commission announced a set of projects for Poland and Hungary worth ECU 86.5 million as part of its contribution to Phare projects. More than half the amount will go on environmental protection, a sector where the Community has taken the lead in supporting major control efforts.

➢ The list of projects includes:

Poland and Hungary

1. *Poland: Environmental protection programme*
2. *Hungary: Environmental protection programme*
3. *Poland/Hungary: Participation in Budapest Regional Environment Centre*

4. *Poland: Basic technical assistance for privatization programme*
5. *Hungary: Support for modernizing the financial system*
6. *Poland/Hungary: Cooperation in the field of economics*
7. *Poland: Sectoral import programme for animal feed and feed-additives*
8. *Poland/Hungary: Technical assistance for implemEnting the Trans- European mobility programme for university studies (Tempus)*

Priorities identified by fact-finding missions sent to these countries by the Commission were similar to those in Hungary and Poland:

(1) *improved access to Western markets;*
(2) *stabilizing and improving food supply;*
(3) *professional training;*
(4) *environmental protection;*
(5) *investment and economic restructuring.*
(6) *Industrial waste, nuclear safety), energy, training and youth exchange*

Specific emphasis varies from country to country. The Commission's initial assess ment of national priorities for each count are as follows:

Bulgaria

- Agriculture and the agri-foodstuffs industry
- environment
- investment (transport and telecom- munications)
- training (management, financial services, scientific and technical), restructuring (chemical and light industries), tourism,
- improved access to markets.

Czechoslovakia

- industrial restructuring
- the environment (pollution control)
- investment (transport and telecommunications)
- scientific and technical cooperation
- improved access to markets.

Romania

- agriculture and food supply (research, production technology, joint ventures)
- environment,
- investment (transport, tourism, smaller enterprises),
- training (management, banking, tourism)
- communications
- agri-foodstuffs industry
- improved access to markets.

(former) Yugoslavia

- agriculture,
- environment (notably pollution of the Danube and Sava basins and of the Adriatic coast)
- investment
- restructuring of the banking sector and the industrial sector
- training (banking, management, taxation systems)
- structural adjustment, including the social aspects
- improved access to markets.

TheCommunity's own contribution to **Phare** is considerable. It contributed ECU 500 million in 1990. The total for 1991 was ECU 795 million with ECU 1 billion earmarked for, 1992. The Commission has continued its coordination task as the scope and geographic coverage of the Phare programme has extended to the restof Central and Eastern Europe.

EXPORT PROMOTION SYSTEMS, EXPORT CREDITS, EXPORT GUARANTEES AND INSURANCES

EC countries provide a sophisticated export promotion system allowing the realization of import/export transactions on the basis of most favourable conditions resp. optimized financial structures and securities, including triangle (3-countries) operations. Also non EC countries have such systems, the general framework (subsidized interest rates and terms) is agreed upon yearly by the OECD, within the so called "OECD CONSENSUS".

Throughout the West European Countries export promotion is following more or less the same schemes. To show the possibilities of taking part in such systems we will take a look at the Spanish Export Promotion and at the Austrian, as non EC country.

SPAIN

➢ International Agreements on Export Credits: OECD Consensus

Regarding publicly subsidised export credits, together with 22 OECD countries, Spain adopted an agreement which foresees that interest rates and terms of subsidised credits are ruled by an OECD cosensus which takes into account the stage of development of the country in question. (lower interest rates and longer terms for less developed countries)

The Actual System of Spanish Export Promotion

Public Subsidies for Export Credits

General Framework

Fundamentally, promotion credits can be in pesetas, ECUs or in any other convertible currency quoted on the Madrid money market. Promotion conditions are ruled by multilateral agreements on publicly subsidised credits.

The agreements are as follows:

- *The OECD Consensus on Publicly Susidised Export Credits*
- *Agreement on Export Credits for the Financing of Ships*
- *Special Credits for the Export of Nuclear Power Stations*
- *Agreement on Export Credits for Earth Stations for Satellite Communication*
- *Special Credits for Civil Aircrafts*

➢ EC RULE:

Export credits which are intended for **operations with EC member states** cannot be publicly subsidised, unless other EC rules explicitly authorize such subsidies.

➢ Types of Publicly Subsidised Export Credits:

- ***Domestic suppliers Credits***
- ***Foreign buyers credits***
- ***Buyer credit lines for foreign buyers and foreign financing institutes***

➢ Borrowing Conditions:

Advance Payments or Cash Payments

At the moment of lending or before the foreign buyer of exported goods or services has to deposit at least 15 % of the export value with funds which do not come from subsidised export credits.

Basis of Calculation

a) The basis of calculation is the FOB value of exported goods and services indicated in the customs invoice or the outward manifest. From this FOB the foreign shares and the shares of trade commissions over 5 % are deducted.

b) In the case of buyers credits for foreign buyers, the interests and commissions accumulating during the credit period are added to the basis, as far as a credit line is stipulated in the credit agreement.

c) In the case of buyers credits also the credit insurance costs can be added to the basis.

d) Costs for freight and transport insurances can be added if this is foreseen by the export contract and if these services are performed by Spanish firms. In case they are foreign services, they are included in the admitted 10 % foreign shares. If the services are performed by the importing country, they are considered **local costs**.

e) In no case interests resulting from default in payment can be added to the basis of calculation.

➢ Credit Ceiling

The maximum credit amount depends on the export value; local costs can be added if they are not higher than the 15 % deposit and the importing country is not classified as relatively wealthy.

1. Pre-Shipment Finance

Conditions for a subsidised pre-shipment financing are the existence of a buying order, the exported commodity may not contain more than 10 % imported parts (exception: up to 30 % from EC countries)

The maximum credit term for consumer goods, semi-finished products and raw materials is three or six months, for capital goods it can be extended until the delivery date.

a) Short Term Supplier Credit (up to 3 years)

Up to 85 % of the contract value (for First Class Export Charter firms up to 90 %)

b) Medium-Term Supplier Credit

Usually up to 85 % (90 % for FCEC firms) of the contract value are preliminaryly financed.

c) Buyer credit

Subsidised credits which are claimed by and extended to the foreign importer (who has to deposit at least 15 %). These credits can be used for financing exports of Spanish capital goods. (The credit is not payed to

the importer=debtor,but it is used for the payment of export invoices of the Spanish exporter=beneficiary).

Cover for the Lender:

Banks which extend these credits can cover up to 90 % (in the case of private borrowers) and up to 95 % (in the case of public borrowers) of the open capital and the interests by means of the credit insurance agencies (in Spain: CESCE).

Share of Foreign Material: Preference for EC

In order to obtain a subsidised credit, the exporter needs a certificate with a detailed description of the origin and destination of the included foreign materials and services,and their share in per cent in the export value. Materials which have been processed forming a completely different (new) product are not considered foreign materials.

EC:

Foreign goods or services included in the exported commodity may have a share of up to 30 % of the FOB value when their origin is an EC country.

Local costs:

Local costs are all expenses generated in the importing country under direct responsibility of the exporter, i.e. goods and services provided by the importing country which are necessary to fulfill the export contract and which are included in the contract price.

The amount of local costs may not exceed the amount of the prepayment or deposit. In the case of exports to countries classified as relatively wealthy, local costs are not financed.

Interest rates

The interest rates of publicly subsidised credits are not lower than the periodically published OECD consensus interest rates.

EXPORT PROMOTION AND FINANCING IN AUSTRIA

The basis for financing Exports was created through the establishment of a modern export guarantee system. Without this, the Austrian export sector would not have been in a position to meet international competition.

This is specially true of the capital goods industry and the opening up of new markets. The latter goal is specially important in view of the high concentraion of Austrian exports in Europe and the resulting dependence of the Austrian economy on Europe's market conditions.

Within the scope of this export guarantee system, claims are paid under guarantees as provided in the Export Promotion Act. Write-offs by the guarantor and interest relief that had to be granted under international agreements as debt relief only reached a total of ATS 9.1 billion (corresponding to 0.8% of the aggregate guarantee turnover).

Through exports made on credit terms assets are formed abroad directly **(by means of supplier's credits)** or indirectly **(through buyer's credits)**, and also through the **acquisition of investments** abroad.

The foreign assets covered by the said federal guarantees form the basis of Kontrollbank's funding operations carried out on domestic and foreign financial markets. In practice, the guarantees assumed under the Export Promotion Act 1981 appear on the Bank's refinancing instruments.

To the extent that the assets formed abroad are funded on foreign financial markets, these operations mean that **capital exports are made possible by capital imports**. In case a tied financial credit is extended or accounts receivable are acquired by a bank, the refinancing procedure consists in the conversion of transactions made on credit terms into cash transactions.

The Bank is responsible for examining applications for guarantees from a banking point of view (banker's judgement on financial standing and handling) and issues and administers the guarantees on behalf of the Republic of Austria

Above all in Eastern Europe, project finance is gaining importance and, along with it, the project analyses undertaken by Kontrollbank in the interest of an effective evaluation of the transactions to be backed by a federal guarantee, is becoming more and more important.

The guarantee premium for **covering the political risks** is determined primarily by the credit rating of the buyer country. In the case of the **economic risks**, the guarantee premium varies according to the record of claims paid; the share of self-participation depends on the buyer's credit standing.

➢ TYPES OF GUARANTEES

The export promotion scheme comprises 11 types of guarantees:

G 1 -	***Guarantee for direct deliveries and services with special types of guarantee***
G 2-	***Guarantee for indirect deliveries and services***
G 3-	***Guarantee for tied financial credits and debt rescheduling agreements***
G 4-	***Investment guarantee***
G 5-	***Turnover guarantee (one foreign customer)***
G 6-	***Country turnover guarantee or comprehensive guarantee (all customers in one country or in several countries)***
G 7-	***Guarantee for stock on commission, equipment guarantee, advance guarantee***
G 8-	***Reinsurance of contract of an export guarantee institution (reinsurance guarantee)***
G 9-	***Guarantee for the acquisition of accounts receivable from export transactions by domestic or foreign credit institutions***
G10 -	***Exchange risk guarantee (not counted towards the authorized liability limit)***
G11 -	***Guarantee by aval on bills of exchange (export acceptance credits)***

Export Financing

Since 1960 the **Austrian Kontroll-Bank** has operated a scheme for financing exports of goods and services primarily on a medium and long-term basis, giving special consideration to exports of Austrian capital goods. This export financing scheme is intended to provide refinancing facilities to Austrian banks which in turn extend credits to Austrian exporters for the sale, or to foreign buyers (or their bank) for the purchase, of Austrian goods and services or for investments in foreign countries by Austrian enterprises.

➢ Supplier Credits and Buyer Credits

Exports made on credit terms can be financed as **supplier's credits** (deferred payment allowed by exporters) or by means of loans extended to the foreign buyers **(buyer credits).**

The exporter granting a supplier's credit to a foreign buyer can obtain refinance from a bank. In case a tied financial credit is extended or accounts receivable are acquired by a bank, this leads to a contraction in the exporter's balance sheet. The bank in question can obtain refinancing from Kontrollbank for the credit portion covered by a guarantee under the Export Promotion Act.

➢ Export Financing for projects in developing countries

Since 1964 the Bank has administered a lending scheme, the so-called **"start-up assistance",** with funds from the **European Recovery Program Fund** and from the **Federal Economic Chamber.** Under that scheme credits are granted to Austrian enterprises to promote the execution of projects which are intended to open up or retain markets in developing countries and which are suited to promote Austrian exports.

Loans under this scheme are granted for the following projects in particular:

- *the establishment of branches, service stations and and repair shops*
- *the assembling of Austrian products*
- *industrial consulting*

These projects may also be carried out in cooperation with foreign enterprises (joint ventures).

In March 1974 the scheme was reorganized and further extended with the help of funds from Kontrollbank's export financing scheme (supplementary financing). Since the end of 1977, start-up credits have been extended in the form of refinancing credits made available to banks. In August 1987 the maximum term for new credits for projects in non-European developing countries was extended from 15 to 20 years; in the case of European developing countries the 10 year term has been retained.

➢ Investment financing

Since July 1973 credits for financing investments abroad have been made available in the form of refinancing credits granted to banks within the refinancing scheme; statistical data of these commitments are included in the figures of the refinancing scheme. In mid-1984, in response to the international development, the maximum term for investment guarantees (G 4) under the Export Promotion Act 1981 and, consequently, that for investment financing operations was raised to 25 years.

THE WORLD BANK GROUP

"The World Bank" refers to the *International Bank for Reconstruction and Development (IBRD)* and its affiliate, the *International Development Association (IDA)*. The IBRD has two other affiliates, the *International Finance Corporation (IFC)* and the *Multilateral Investment Guarantee Agency (MIGA)*. The Bank, the IFC, and MIGA are sometimes referred to as the "World Bank Group."

The World Bank Group´s functions and tasks

(extract: Annual report, papers)

The **IBRD's** charter spells out certain basic rules that govern its operations. It must lend only for productive purposes and must stimulate economic growth in the developing coun- tries in which it lends. It must pay due regard to the prospects of repayment. Each loan is made to a government or must be guaranteed by the government concerned. The use of loans cannot be restricted to purchases in any particular member country. And the IBRD's decisions to lend must be based on economic considerations alone.

The **International Development Association** was established in 1960 to provide assistance for the same purposes as the IBRD, but primarily in the poorer developing countries and on terms that would bear less heavily on their balance of payments than would IBRD loans.

IDA's assistance, therefore, is concentrated on the very poor countries-those with an annual per capita gross national product of $580 or less (in 1989 dollars). More than forty countries are eligible under this criterion. Membership in IDA is open to all members of the IBRD, and 139 of them have joined to date. The terms of IDA credits, which are made only to governments, are **ten-year grace periods, thirty-five or forty-year maturities**, and **no interest.**

The **IFC** was established in 1956. Its function is to assist the economic development of less-developed countries by promoting growth in the private sector of their economies and helping to mobilize domestic and foreign capital for this purpose. Membership in the IBRD is a prerequisite for membership in the IFC, which totals 141 countries. Legally and financially, the IFC and the IBRD are separate entities. The IFC has its own operating and legal staff, but draws upon the Bank for admin- istrative and other services.

MIGA, established in 1988, has a specialized mandate: to encourage **equity investment** and other **direct investment flows** to developing countries through the mitigation of noncommercial investment barriers.

To carry out this mandate, MIGA offers investors guarantees against noncommercial risks; advises developing member governments on the design and implementation of policies, programs, and procedures related to foreign investments; and sponsors a dialogue between the international business community and host governments on investment issues.

➢ Lending for Eastern and Central Europe

The Bank's lending strategy for Eastern and Central Europe aims at supporting structural and institutional measures critical for the success of reform programs through structural- adjustment loans, as well as through technical-assistance loans that provide external expertise in priority areas and support needed institutional development. The amount of Bank com-mitments to the ECE countries during the year expanded rapidly, reaching $2.9 billion, an in- crease of $1,098 million over the previous year (1990).

➢ Lending Principles

The Bank lends funds for a carefully selected and clearly defined projects. These projects - which generally require the borrowing country to buy goods, civil works, and services in the international marketplace - offer many potential business opportunities. About 30,000 contracts are awarded annually to firms by borrowers of Bank funds. Approximately 70% are for goods and equipment, 20% for civil works, and 10% for consulting services.

➢ Investment loans and adjustment loans

The Bank's lending activities fall into two basic categories - investment loans and adjustment loans. Investment loans, by far the most frequent type of lending, account for more than 75% of the Bank's total annual commitments. These loans finance individual projects and segments of a country's investment program in a specific sector, such as transportation or agriculture. Adjustment lending includes structural adjustment loans (SALS) and sector adjustment loans (SECALs). SALs help countries reform economic and fiscal policies, and address balance of payments problems. SECALs support more narrowly focused reforms in a particular sector.

➢ Project types

The Bank finances projects in a wide range of sectors - from agriculture, education, energy, environment, and health to industry, population, power, telecomm unications, transportation, and urban development. Each sector includes a variety of projects and the procurement of many types of goods and services.

Bank-financed agricultural projects, for example, can include development of tree crops, dryland farming, irrigation, livestock, forestries, fisherie s, food processing, grain storage, agricultural extension, and technical assistance. Implementing an agricultural project might entail procuring food processing facilities, animal feed, fertilizer, seeds, livestock, insecticides, pesticides, irrigation equip ment, pumps, and agricultural equipment. Construction of civil works like dams and irrig ation canals might be necessary as well.

A similarly wide range of projects occurs in the energy sector. An ener gy loan, for example, might finance constructing or rehabilitating and upgrading a ma jor power facility, hydroelectric dam, thermal-electric plant, and power transmiss ion and distribution facilities. It might also finance oil and gas exploration, pipelines, and processing facilities.

In the health sector, for instance, a Bank loan might finance equipment for hospitals, laboratories, and clinics, as well as furniture, pharmaceutic al supplies, vaccine production plants, and mobile health units.

➢ COMMERCIAL PROJECTS - TRIANGLE TRADE AND COOPERATION

According to our recent talks with World Bank representatives concerning triangle operations (Africa - Western Europe - Eastern Europe) the echo on the ides of linking African producers and businessmen with the restructuring process in Eastern Europe was warmly welcomed.

Similar to the discussions in London at the European Bank (EBRD), it was pinted out that main requirements are ***projects that make sense***. The World Bank will not finance "holes in the budgets" when financing infrastructural investment, but will finance such investments within the framework of an economically sensful project (preferably: regional projects).

As the World Bank´s activities are concentrated on work with the governments or government agencies in the countries where the loans should go to, the Bank would not directly finance commercial projects of private firms, but could - for interesting projects - provide it´s whole system of experience and instruments - i.e. in particular cooperation schemes with the IFC and MIGA.

The Bank would prepare the environment of the project (negotiation with governments, preparation of guarantees, project specific funds to governments etc.); the IFC would assess the project, decide on financing and elaborate a proper financing structure; MIGA would be bound into the project by e.g. insuring sovereign risks, exchange risks etc. Helpful could be the integration of the APDF (Africa Project Development Facility / Nairobi) or the Venture Capital Fund (Nairobi).

➢ Coverages of MIGA

MIGA's Guarantees program protects investors against losses from currency transfer, expropriation, war and civil disturbance, and investment-related breach of contract by host governments. In addition to new projects, MIGA can insure investments in the expansion, privatization and financial restructuring of existing projects that are registered with MIGA before the investments are made or irrevocably committed. No minimum investment is required to be eligible for MIGA insurance.

Eligible investments include contributions in cash or in kind in the form of equity, loans made or guaranteed by equity holders and certain forms of non-equity direct investment. MIGA can insure a loan by a financial institution if the loan is related to an investment covered or to be covered by the Agency.

MIGA's standard policy covers investments for 15 years although coverage for a project may be extended to 20 years in exceptional cases.

➢ Cooperation between the World Bank and the European Bank for Reconstruction and Development

The EBRD has expressed interest in cofinancing with the Bank in the areas of enterprise restructuring, privatization, and financial-sector development, as well as projects in the energy, telecommunications, and environment sectors.

In June 1991, the EBRD cofinanced a Bank-assisted heating-supply project in Poland designed, among other things, to encourage energy conservation and reduce environmental pollution.

➢ Cooperation with the International Monetary Fund

The Bank and the International Monetary Fund share the broad objectives of promoting sustained growth and development of member countries, and they have been assigned differing but complementary roles in pursuing this objective. The two institutions are expected to ensure close collaboration in order to serve members with maximum effec- tiveness.

➢ Cooperation with the International Finance Corporation

The International Finance Corporation (IFC), a member of the World Bank Group, promotes private enterprise in its developing member countries.

It does this by financing sound private-sector projects, mobilizing debt and equity financing in the international mar- kets for private companies, and providing technical assistance and advisory services to businesses and governments .In recent years, the IFC has increased its resource-mobilization activities, in many instances raising substantial amounts of debt and equity financing for companies with rela- tively small outlays of its own funds.

In addition to raising funds through cofinancing, loan syndications, and underwritings, the IFC also mobilizes funds by sponsoring, underwriting, or investing in country and debt- conversion funds.

TRIANGLE TRADE AND COOPERATION

SELECTED SCHEMES

A VARIETY OF POSSIBILITIES

Our talks with much more 100 top managers of selected Eastern European production companies, exporters, representatives of trading companies, of private banks and of the international financing institutions, have resulted in the possibility to define specific sets of concrete bilateral, triangle or multilateral trading and cooperation schemes.

Schemes to be able to reconstruct lost market positions, schemes to be able to gain new market niches - under complicated overall conditions like in reconstructing Eastern Europe or in developing Africa. And of course, schemes linked with proper and creative financing structures.

The following pages will demonstrate some selected schemes, an extract but typical for possible operations. Selected because of their good chances to be realized, and, of course, selected because of meeting national economic requirements as well as profitability for the partners involved.

Not everything is new, but new is the complex linkage of economic sectors (not just relying on classical barter business) and the even more complex linkage of triangle and multilateral projects linked with proper and also complex financial instruments.

Within the frame of this study it is not possible to simulate full bankable project and financing concepts needed for realisation of the demonstrated schemes. This is a matter for *follow ups*. A matter to be negotiated between partners.

We have tried to make the general ideas understandable in laying them down graphically: Two complex and practically proved schemes we would like to comment detailed:

The "Triangle Joint Venture" (Agricultural Machines / Food Processing) and the "Harbour Modernisation Investment - Cold Storage Facilities".

AGRICULTURAL MACHINERY - AN EXAMPLE

In the field of agricultural machines the Eastern European countries are producing a big variety of products with very good quality and competitive prices. The most intersting products we could find in the former USSR, in Hungary and in Bulgaria. The wide range of offers comprises:

- ***Standard Tractors***
- ***Heavy duty Tractors***
- ***Mini Tractors and Equipment***
- ***Harvester Machines, Windrowers***
- ***Accessoires for Cultivation***
- ***Tractor Mounted Sprayers for Chemical Protection***
- ***Trailors***

etc.

Hungary, for example, has a great tradition in agricultural production, one of the reasons why the agro-machinery sector is very developed (about 30 % of the production goes into exports; one third of agricultural land is already privatized).

For the realization of machinery and technology imports to Africa proper mechanisms and creative financing have to be developed. Even if the EC, for example, decided against the inclusion of banana in the GATT negotiations and will apply quotas to banana imports from e.g. Latin America, ACP producers will have to increase productivity, efficiency and diversfication in agricultural production.

As far as financing of imports is concerned there are following main financing structures thinkable:

A) Delivery against cash / LC Basis

B) Delivery against direct compensation (exporter takes compensation goods)

C) Indirect barter transaction combined with factoring (the compensation goods will be taken by the exporter´s bank (the bank´s trading house)

D) Regular Export Leasing operation

C) Complex trilateral (triangle) or multilateral financing and cooperation structures

COMPLEX OPERATION I

"Triangle Agricultural Joint Venture"

Basic Structure

Offer: Eastern European Agro - machines

Demand: Agro - machines / African agricultural producer

Problem: Currency shortage

Possible Strategy:

- *Exporter of agro-machines (producer) and importer of machines (agro-producer) form a food processing joint venture under participation of a western partner. The African agro exporter will supply the joint venture for fair (favourable) commodity terms; the exporter of East European agro- machines will enter the joint venture with cash capital or with processing facilities. The West European partner will enter with capital and will bring in management know how, financial know how, marketing, accountancy and tax know how, and currency exchange / transfer operation`s know how how.*
- *The joint venture's sales contracts will be assigned to the leasing company or the financing bank. The joint venture opens an account at the leasing-financing bank/entity, sales revenues will be transferred minus the leasing rates.*
- *Necessary: Performance Guarantee for agricultural supply: Bank / or Performance Bond; asset backed leasing contract; 3-5 years maximum maturity.*

COMPLEX OPERATION II :

Harbour Modernisation Investment - Cold

Problem: Modernisation of harbour facilities - shortage of hard currency

Existing: Bankable feasibility study for investment & pay back

Background: State guarantees or local bank guarantees not accepted by financing western banks

Triangle Operation:

a) *Harbour authority contracts customers (shipping companies using harbours) on leasing agreements with Western hard currency earning transportation company*

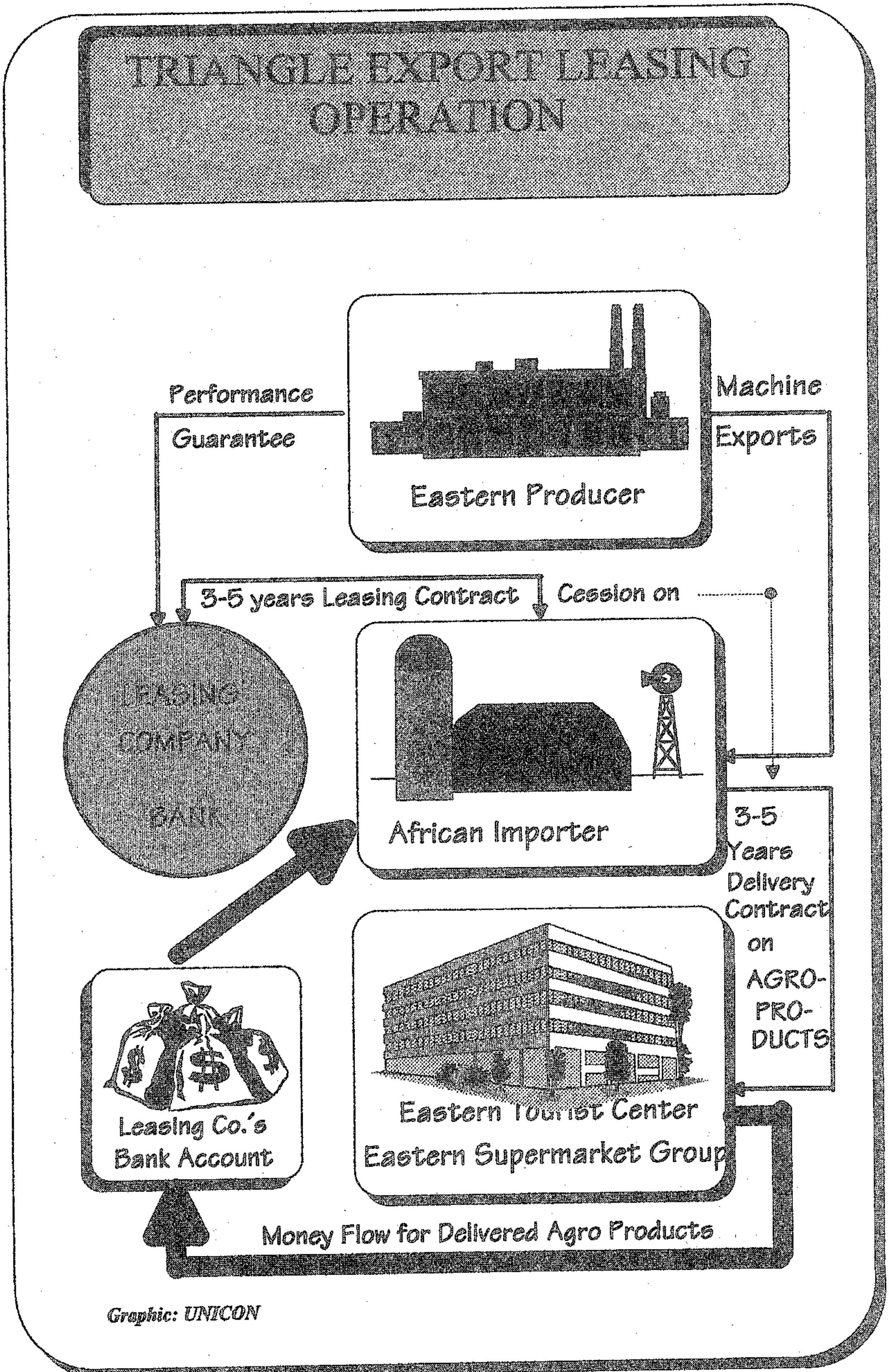
b) *Customers (local shipping companies) are regular debtors to harbour authority*

c) *Western transportation company leases 1/2/3 ships from local shipping com pany*

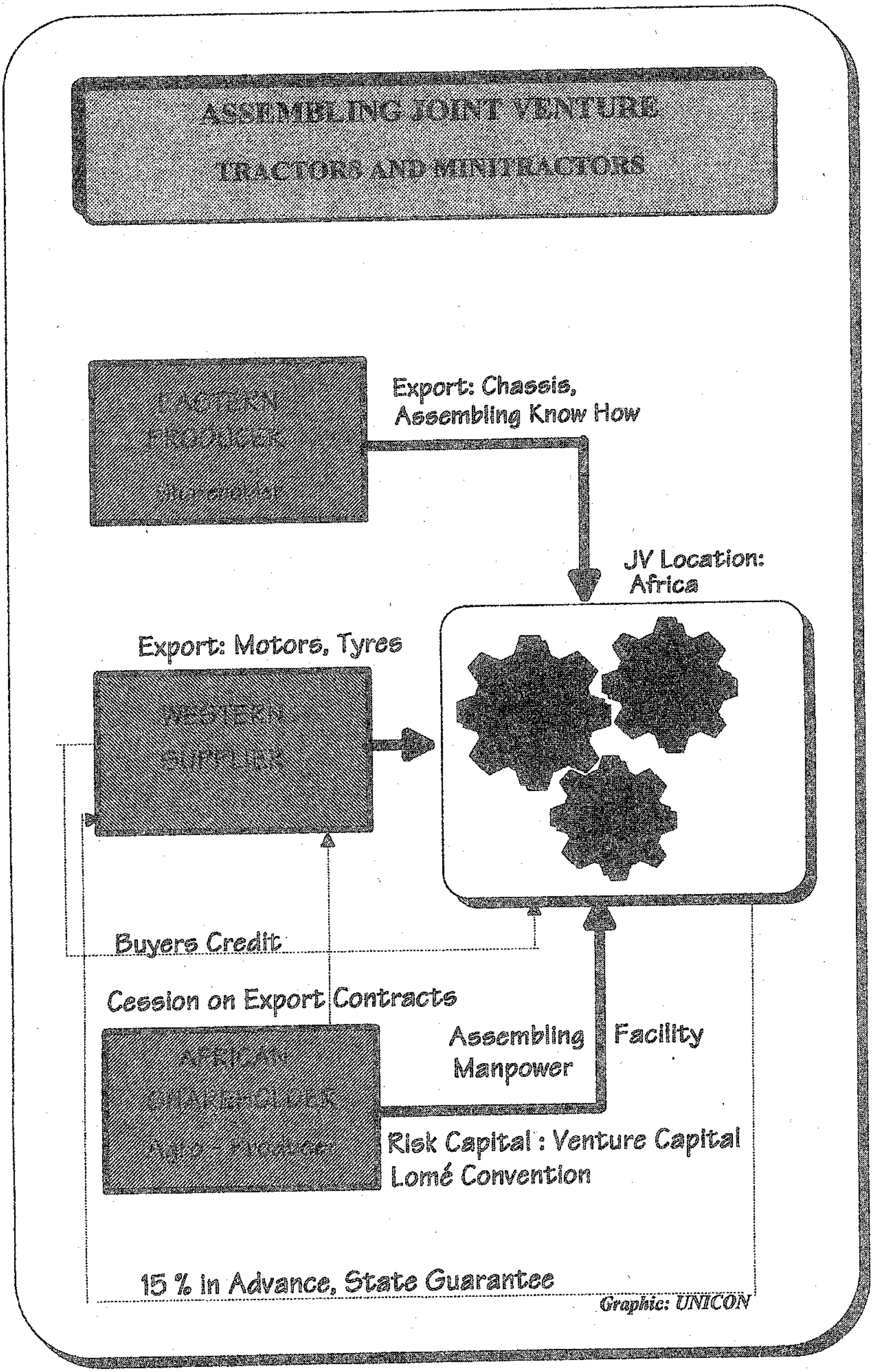
d) *Cold storage financing bank / leasing company makes contract with Eastern exporter / African Investor / West European transport company*

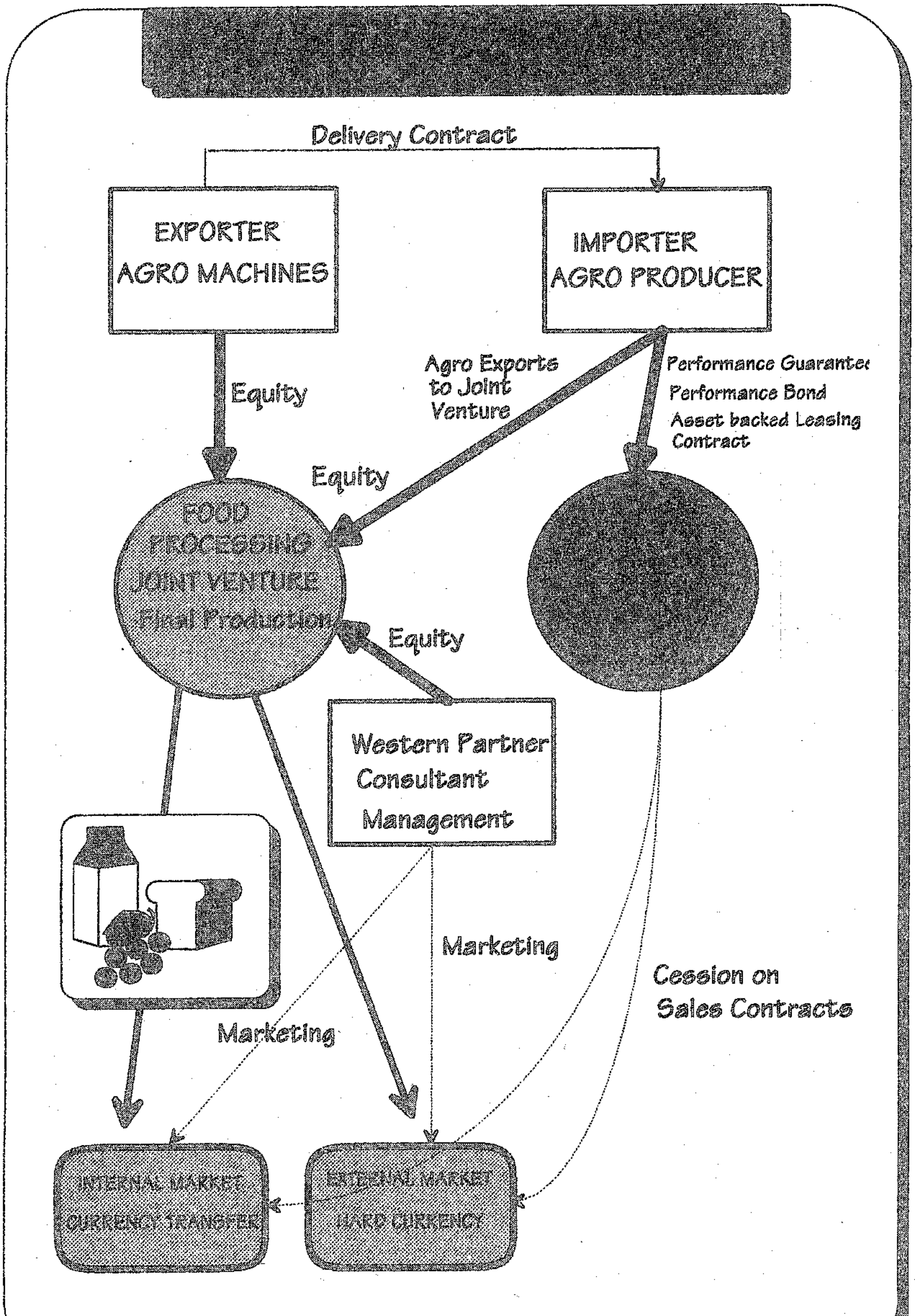
e) *Hard Currency earnings from operations performed by Western customer go to bank account at West European bank, revenues minus leasing rates (capital repayment & interest) are transferred to African shipping company*

f) *Shipping company balances with Harbour Authority, investment is settled.*

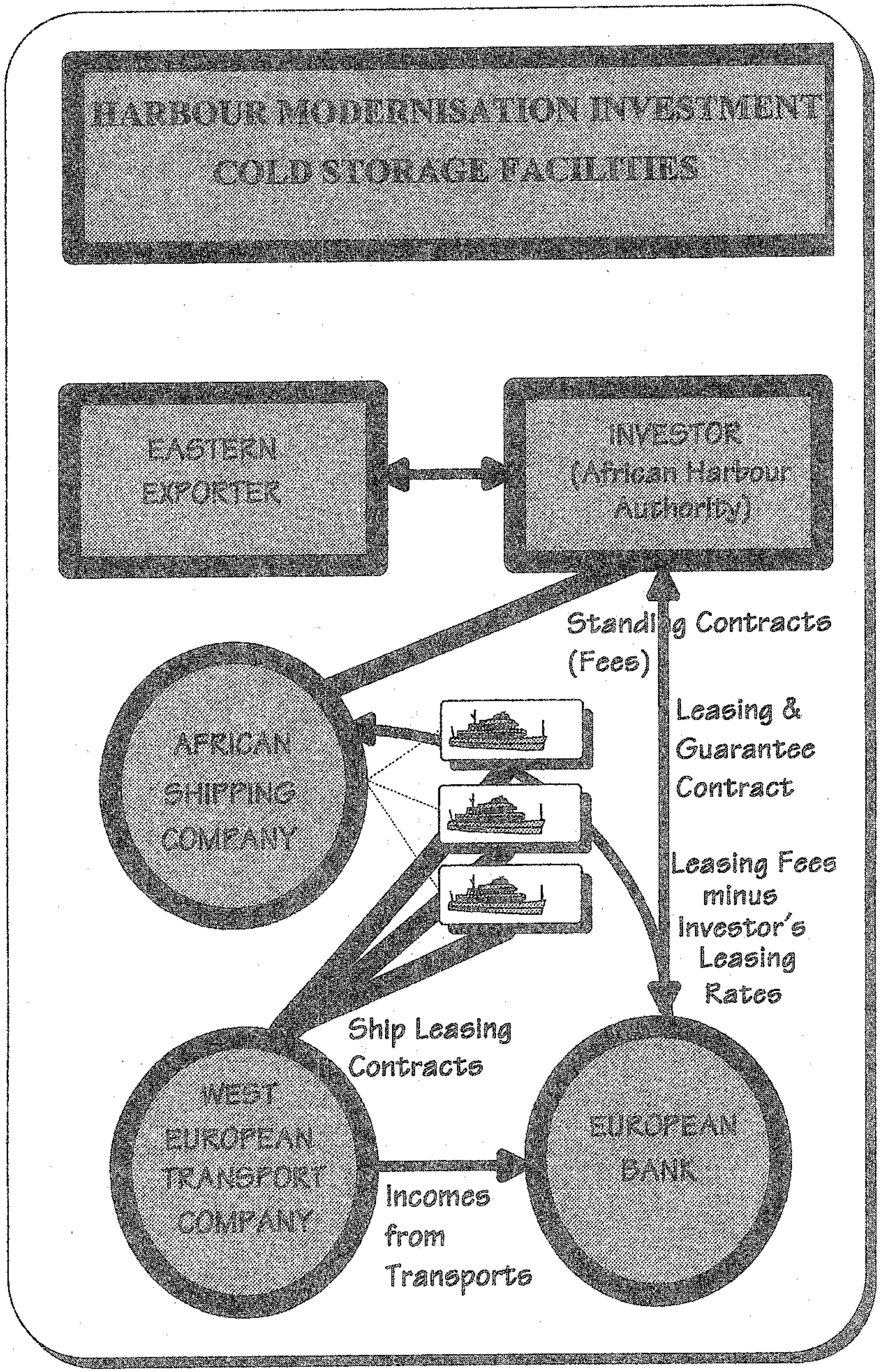


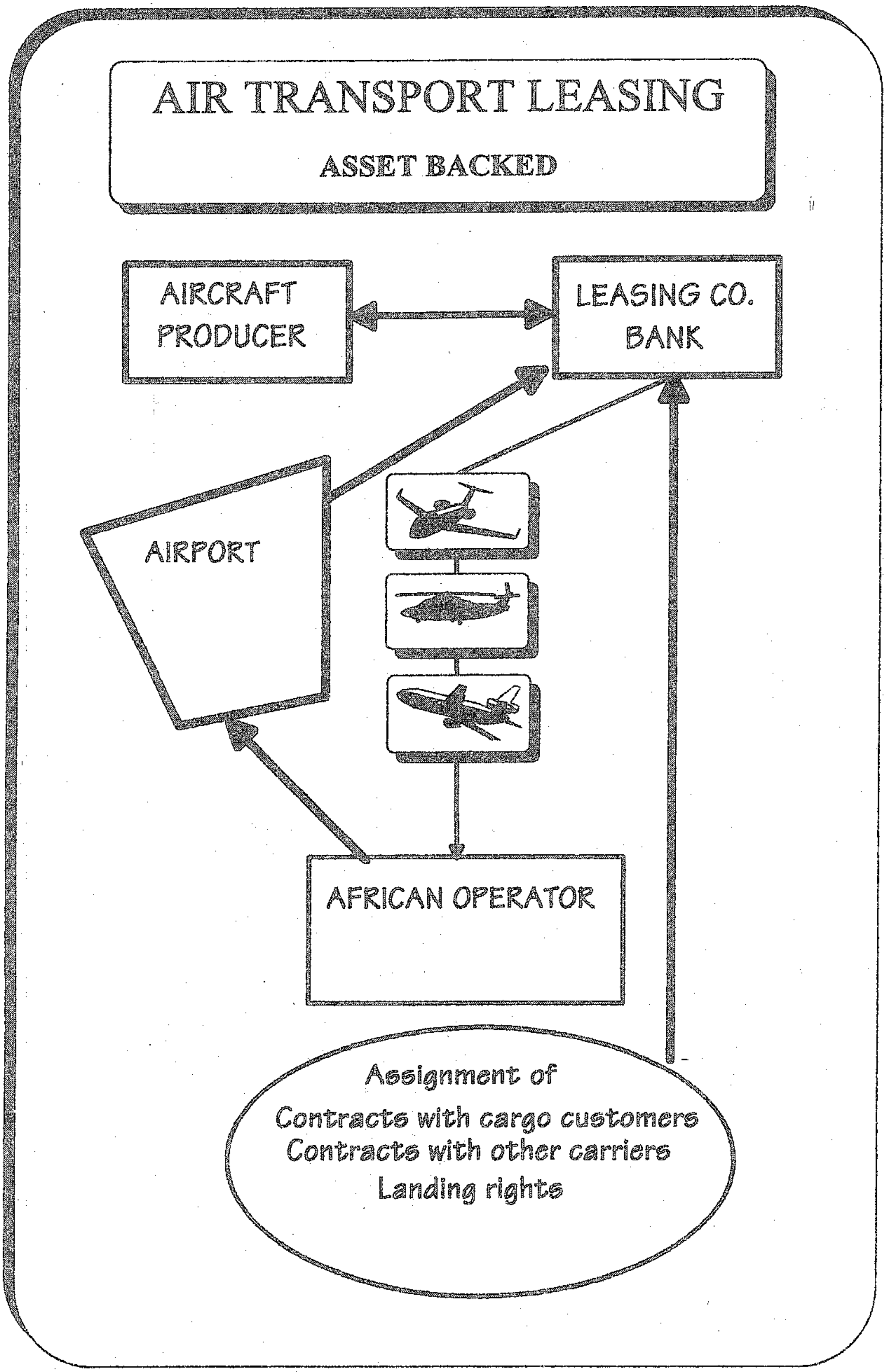
Graphic: UNICON

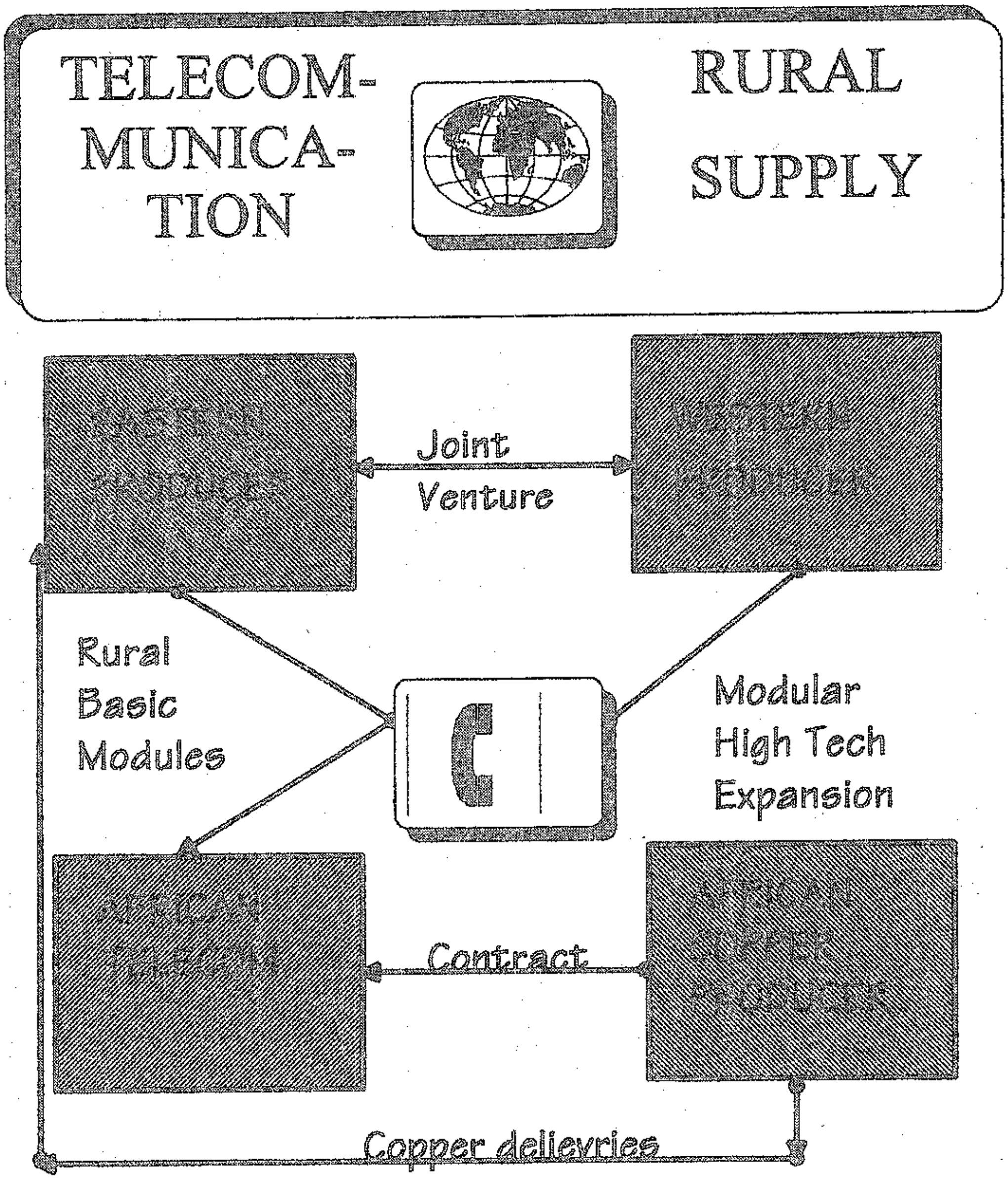

ASSEMBLING JOINT VENTURE
TRACTORS AND MINITRACTORS
EASTERN PRODUCER
Shareholder
Export: Chassis, Assembling Know How
JV Location: Africa
Export: Motors, Tyres
WESTERN SUPPLIER
Buyers Credit
Cession on Export Contracts
Assembling Manpower
Facility
AFRICAN SHAREHOLDER
Agro - Producer
Risk Capital : Venture Capital
Lomé Convention
15 % in Advance, State Guarantee
Graphic: UNICON



Graphic: UNICON


HARBOUR MODERNISATION INVESTMENT
COLD STORAGE FACILITIES
EASTERN EXPORTER
INVESTOR (African Harbour Authority)
Standing Contracts (Fees)
Leasing & Guarantee Contract
Leasing Fees minus Investor's Leasing Rates
AFRICAN SHIPPING COMPANY
Ship Leasing Contracts
WEST EUROPEAN TRANSPORT COMPANY
EUROPEAN BANK
Incomes from Transports

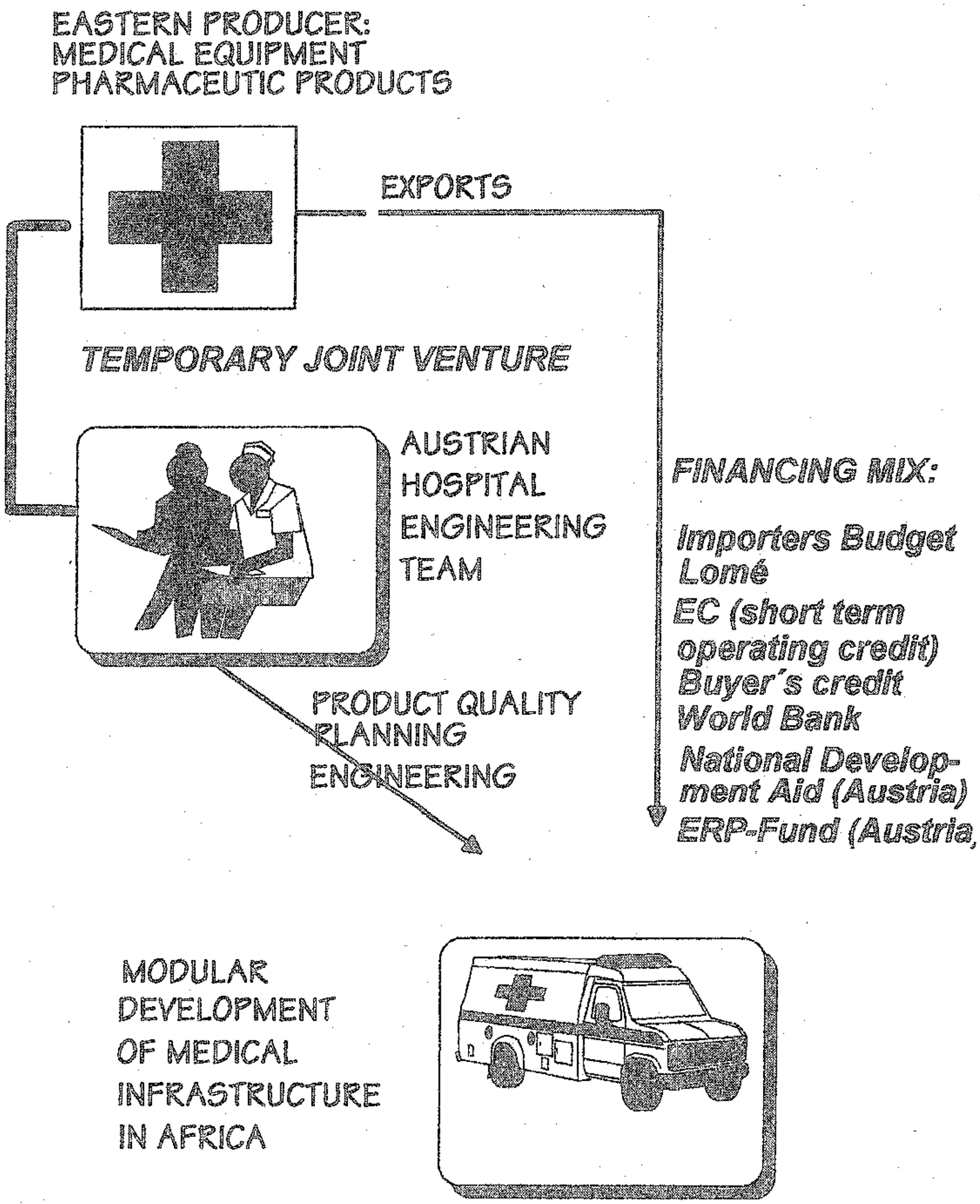

AIR TRANSPORT LEASING
ASSET BACKED
AIRCRAFT PRODUCER
LEASING CO. BANK
AIRPORT
AFRICAN OPERATOR
Assignment of
Contracts with cargo customers
Contracts with other carriers
Landing rights



MIXED FINANCING SCHEME

Graphic: UNICON

JOINT PROJECT: MEDICAL INFRASTRUCTURE



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