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SOVIET BEHAVIOR IN INTERNATIONAL FINANCIAL MARKETS

If informed policy choices are to be made in the ongoing political and military competition with the Soviet Union, the Western alliance must be able to assess the state of the Soviet economy. Such an assessment requires, among other things, a clear view of Soviet holdings and transactions in hard-currency financial markets. Soviet financial behavior may also provide insights into the political goals and motivations of high-level Soviet policymakers, given that the Soviet economy is centrally planned.

Unfortunately, Western understanding of Soviet transactions in the international financial markets is far from comprehensive. Analysts must rely on imperfect information supplied by Western parties involved in transactions with the Soviets. To integrate some of this information and evaluate possibilities for collecting more, C. R. Neu and John Lund at The RAND Corporation's National Defense Research Institute conducted a study for the Under Secretary of Defense for Policy.[1] The study included analysis of published data on Soviet hard-currency transactions in financial markets and some twenty interviews with government officials, bankers, and other observers of international financial markets in Washington, New York, and London. Several issues were addressed.

THE OBSERVABLE SOVIET HARD-CURRENCY BALANCE SHEET

The Soviet Union enjoys a good "name" in international credit markets. Few countries are able to borrow from Western banks on more favorable terms, mainly because the Soviet Union pays its loans on time, but partly because the Soviets maintain large amounts of hard-currency funds on deposit in Western banks. Those deposits as of the end of 1986 were estimated at $15 billion by the Bank for International Settlements (BIS). Apparently, the Soviets value these deposits as loan collateral, as a reserve against short-term fluctuations in their need for hard currency, and as a hedge against the possibility that Western governments will at some point restrict their access to hard-currency loans. Indeed, on a number of occasions the Soviet Union seems to have borrowed hard-currency funds for no reason other than to add to its hard-currency deposits.

Turning to the other half of the balance sheet, gross Soviet debt at the end of 1986 was estimated to be about $38 billion by the BIS and the Organization for Economic Cooperation and Development (OECD).[2] Several nations have larger gross debts, and the Soviets' net hard-currency debt of some $24 billion is exceeded by numerous countries. It is generally recognized, however, that the BIS-OECD estimates of Soviet debt are incomplete—but how incomplete?

THE POTENTIAL FOR UNOBSERVED BORROWING

It has been suggested that Soviet-controlled banks operating in the West may forward loans to the Soviet Union in such a way that they are not recorded by the BIS. That could be done by passing funds through banks that do not report to the BIS or through transactions between West and East German banks, which are also not reported to the BIS.

While this is a plausible scheme, most experts believe that hidden borrowing is minimal. The Soviet-controlled banks, which report total assets on the order of $10 billion, are too small to accommodate significant hidden additions to Soviet debt. False reporting would likely be discovered, and the Soviets value these banks too highly to risk them for whatever might be gained by hiding a few transactions.

Thus, **present figures are probably close to correct.** However, the Soviets may soon be entering the Euronote

[1]R-3524-USDP, *Toward a Profile of Soviet Behavior in International Financial Markets,* The RAND Corporation, August 1987.

[2]The BIS and the OECD reported that about 48 percent of the gross Soviet debt was held or guaranteed by Western governments as a result of export credits. (Such credits have not been granted to the Soviet Union by the U.S. Export-Import Bank since 1977.)

market, where debt issues may not be captured by current reporting requirements.

WHERE THE BORROWED FUNDS GO

In simple terms, the Soviets can do three things with borrowed funds: they can allow reserves to accumulate, they can finance imports, or they can lend (or give away) the money. In 1983, for example, BIS and OECD figures indicated a $1.4 billion excess of borrowing over lending by the Soviets. There was no appreciable growth of reserves. Thus, one would have expected that Soviet net imports of goods and services would have been $1.4 billion. Instead, the Soviets experienced net exports of $5.4 billion in 1983, according to the U.S. Central Intelligence Agency. If the accounts are to balance, we must assume that the Soviets undertook enough unobserved lending to balance the observed net borrowing plus the currency brought in by the net exports, or a total of $6.8 billion.[3] Where might this money have gone?

The most likely recipients of unobserved Soviet hard-currency lending are the USSR's Third-World "client" states outside the Soviet bloc's Council for Mutual Economic Assistance. (Hard-currency transactions are much less prevalent within the CMEA, whose Third-World members are Mongolia, Vietnam, and Cuba.) Indeed, other RAND research has indicated that Soviet loans and aid to non-CMEA countries amounted to $6.9 billion in 1983.[4]

[3]More precisely, a capital-account surplus of $1.4 billion and a current-account surplus of $5.4 billion were observed, requiring an unobserved capital-account deficit of $6.8 billion.

THE SOVIET STYLE OF OPERATIONS IN FINANCIAL MARKETS

In international credit markets, Soviet financial managers are perceived as hard bargainers, seeking and often getting very good loan terms. They have shown a preference for repeated borrowing in moderate amounts, instead of arranging less frequent "jumbo" credits. They thus maintain a regular presence in the markets, drawing less attention to their borrowing than they might otherwise.

In money markets, the Soviet style is conservative. Almost all Soviet hard-currency assets are in bank deposits with maturities of less than a year.

In foreign-exchange markets, Soviet financial managers are active and aggressive, sometimes transacting in very large lots. In doing so, they stake out a position for themselves as major players, reducing their dependence on other participants and thereby gaining some privacy.

DIRECTIONS FOR FUTURE RESEARCH

The NDRI analysis should be regarded as preliminary. Firmer conclusions will have to await further research. **Our knowledge is especially incomplete in regard to the channels and methods of Soviet transactions.** Much could be gained from a systematic review of the financial press and of information published by foreign banks and ministries, from further interviews with foreign bankers and financial-market observers, and from efforts to identify on what terms analysts might gain access to sensitive financial information.

[4]R-3419-NA, *The Costs and Benefits of the Soviet Empire, 1981–1983,* Charles Wolf, Jr., et al., The RAND Corporation, August 1986.

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