

# First “bad bank” set up for Eastern Europe

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In the middle of January the first so-called “bad bank” for Eastern Europe was set up in the Austrian capital of Vienna. It has initially been allotted funds totaling around \$250 million, but is expected to receive a much larger sum—\$1.5 billion from the World Bank.

Lars Thunell, vice-president of the International Finance Corporation—a subsidiary of the World Bank, which set up the fund—justified the move by pointing out that Eastern Europe was one of the regions that had been hardest hit by the worldwide financial crisis. This has led to a dramatic rise of bad loans, which will either never be repaid, incompletely repaid or only paid at a much later date than originally agreed.

The bad bank has a dual purpose:

Firstly, its priority is to protect West European banks from defaults on billions of euros of loans—such as those recently declared by the German Bavarian State Bank—by centralizing such toxic assets and other securities in the new “bad bank.”

Secondly, banks freed from the burden of such bad loans on their balance sheets will once again be able to trade and speculate freely. The “toxic assets” will be exchanged on the basis of a decreased book value for debenture bonds. Banks with large bad loans on their balance sheets, which until now were denied fresh capital from central banks, will now be able to submit their debenture bonds with central banks as security for new credits. The whole circus of highly profitable financial speculations that led to the financial crisis in the first place can recommence, as if nothing had happened.

Following the collapse of the Soviet Union and the Stalinist regimes in Eastern Europe two decades ago many banks in Germany, Austria, Italy, Sweden and other states awarded loans amounting to several hundred billion euros to Eastern Europe countries. These loans are now overdue. Even the loss of just one of these loans could lead to the state bankruptcy of some countries. According to the World Bank, credits of least €200 billion are under threat.

The role of the newly created bad bank is now to redeem the toxic credits that had been largely written off by major banks. It is no coincidence that the new bad bank is to be

located in Vienna. On January 26, Austrian Financial Market Authority Co-Chairman Helmut Ettl announced he expected “massive write-offs” by Austrian banks in the coming year. Austrian banks have the largest exposure to Central and Eastern Europe, with substantial amounts of foreign currency-denominated assets (particularly mortgages) in Hungary, the Czech Republic, Croatia and Slovakia.

The bad bank is to be run under the name “CEE Special Situation Fund” by the US investment group CRG Capital, which has its headquarters in the tax haven of Delaware. According to CRG, the company will concentrate on redeeming toxic assets in the markets of Poland, Romania, Hungary, the Baltic countries and Ukraine. CRG does not explain how it intends to recover the loans but, according to CRG finance boss Dorian Macovei: “We have a great deal of experience and 90 specialized lawyers working in the US alone.”

The “specialty” of such lawyers has little to do with existing laws governing business and finance practice, and much more to do with measures aimed at identifying debtors and then working with detective and security agencies to force them to repay their debts. In Eastern European countries the personnel of many such agencies are frequently drawn from the security forces of the former Stalinist state bureaucracies, who possess the necessary “knowledge on the ground” to find debtors and bully them to pay up.

The entire “bad bank” operation is aimed above all at rescuing Western European banks at any price and will do nothing to assist the hard-hit populations of the states in Eastern Europe. Success for this operation, however, remains extremely questionable. All of the calculations involved depend on a recovery from the deep economic recession in Eastern European economies. The reality is that in many states the economic situation is worsening.

So far the International Monetary Fund has been forced to intervene to provide financial help for Hungary, Romania and Ukraine in order to prevent the collapse of their economies. The latest prognoses for the region are gloomy.

During the past two years, Latvia’s economy shrank by more than 24 percent and, according to the IMF, the country’s gross domestic product will decline a further 4

percent this year. Estonia's total indebtedness amounts to 140 percent of its GDP and is only exceeded by Romania, with 160 percent.

Baltic states are estimated to have the highest levels of toxic assets (14.5 percent) followed by Estonia (12 percent), Romania (11.2 percent) and Bulgaria (10.1 percent). Levels are also high in Lithuania and Hungary. With the economic downturn set to continue in these countries in 2010, the levels of these bad loans are also set to rise.

An additional factor is rapidly rising unemployment, which in turn increases indebtedness of individual consumers. Unemployment in Eastern Europe is already clearly higher than in the West, and this difference will continue to grow. The number of Eastern European countries with an official unemployment rate of more than 10 percent has grown in the past few months.

Latvia has the highest official level of unemployment at 22 percent, while double-digit jobless rates exist in Poland, Hungary, Slovakia, Slovenia, Serbia and Croatia. According to figures from the First Bank AD Novi Sad, unemployment in Serbia will rise from the current 16.5 percent to 18.5 percent in 2010. At the same time, such official unemployment figures invariably tend to underestimate the real situation. Taking into account underemployment, the real unemployment rates are likely to be much higher.

Contrary to all forecasts, the economic situation in Eastern Europe has failed to improve. The new bad bank is aimed at ensuring there is not a complete retreat by Western banks from Eastern European business life, which in turn would have a disastrous knock-on effect for Western companies.

Michael Steinbarth, director of the Fitch rating agency, fears that "Some market players could reconsider their Eastern Europe strategy this year." This refers to the Hypo Group Alpe Adria and its Austrian subsidiary, which is pulling out of its considerable interests in the Balkans.

The Belgian KBC Bank NV also plans to withdraw from Eastern Europe. The finance house recently announced that it would float 30-40 percent of its Czech subsidiary on the Prague stock exchange and sever its connections to the largest Slovenian bank, NLB.

The US economist and columnist Mark Weisbrot bluntly revealed to *BusinessNewsEurope* the policy of the IMF in this regard: "The practical politics of the IMF are laid down by the US Treasury Department and Western governments... You do not hear anything from the victims of their politics—they are not represented."

"If one looks at the many hundreds of billions of dollars raised by the IMF in the last one-and-a-half years, it is very evident in my view that this money is to be used to cover for the possible losses of west European banks in central and Eastern Europe," Weisbrot continues. "There is no other

conceivable disaster for which one would use these funds," he said. "The IMF is not using these funds to rescue countries such as Latvia. It goes to the Swedish banks when they have to be rescued. If the governments of Sweden or Austria must be saved, then these funds are used."

While the IMF and the European Union are doing all they can to minimize losses for Western finance institutions, they are at the same time applying the thumbscrews to East European governments to continue and intensify their austerity measures. It is the population of these countries who pay the price.

In Hungary, the total number of those citizens no longer able to repay their financial obligations rose to over 800,000 in January. This means that 8 percent of the population are now on banking indexes prohibiting them from taking out further loans. The number of companies—mainly small or middle-sized enterprises—unable to keep up with their credit repayments is around 180,000. In the last two months alone, a further 2,500 companies joined this list. The number of company bankruptcies throughout Eastern Europe rose in 2009 by 56.1 percent compared to 2008.

In Latvia, the adviser to the Latvian central bank, Uldis Rutkaste, recently told business representatives in Riga that the government would continue its "pro-cyclical fiscal policy." In layman's language, this means further tax increases, wage cuts and punishing attacks on the country's social infrastructure. These are the types of measures laid down by the IMF as the basis for further credits.

A week ago a group of Latvians set up nearly a dozen tents in front of the government building in Riga seeking to oppose the economic policies of the Latvian government with a hunger strike. Posters at the protest read: "Against social genocide." Increasing numbers of political commentators are predicting an outburst of mass protests in the near future.



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