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Secretary of State for Trade and Industry

10 July 1984

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The Rt Hon Nigel Lawson MP
Chancellor of the Exchequer
HM Treasury
Parliament Street
London SW1

D Nigel,

ECGD POLICY TOWARDS RESCHEDULING COUNTRIES

I am proposing to authorise a change in ECGD's policy towards the provision of support to countries which have rescheduled their guaranteed debts, which should be helpful in the context of the present dialogue with the developing countries on their debt problems. The proposal would be to allow ECGD cover to be resumed at an earlier stage than in the past to support credits for British goods which contribute to the economic recovery of the debtor country. This facility would be reserved for those developing countries which have been taking resolute action to carry out an effective adjustment programme with the IMF. It should therefore help to serve the general policy discussed at the Summit of finding a way of rewarding those debtor countries that are behaving responsibly, in contrast to those (like Argentina and Venezuela) that are at present failing to face up to their responsibilities.

2 The arguments for making this change and the criteria that would apply to the provision of further ECGD cover for certain selected markets are set out in the enclosed paper. These have been discussed and agreed at official level and I suggest that this new policy should be put into operation, subject to the agreement of the Prime Minister and colleagues, on the carefully controlled basis that is proposed. The essence of these proposals is that only the "better performers" among the debt rescheduling countries will be rewarded (for example Mexico, Brazil and Yugoslavia might fall into this category): they will have to be adhering to a strict IMF adjustment programme and meeting their current payment obligations. Ministerial approval will be sought in each case, after discussion at official level in the Export Guarantees Committee, before cover is restored. Normally the level of cover will be set at a lower level than that operating before the debt

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rescheduling application was made, but this should not cause problems as imports will generally be constrained by the stabilisation programme. Moreover, it is intended that the credits will be used to support British exports which should contribute to the economic recovery of the debtor country, (so that ECGD cover for prestige and military projects will remain blocked).

3 This change should assist our bilateral political and trading relations with these debtor countries and I am conscious of the fact that the UK was in danger of becoming isolated in this area by having no ECGD capacity to support new business following the successful completion of the IMF and debt restructuring negotiations. Nevertheless, I do recognise that the risks remain high, because even well-intentioned governments may be unable to carry through their adjustment programmes because of internal opposition or the slowness of their economic recovery. I would intend this development in the use of ECGD's Section 2 (national interest) powers to be announced to the House (probably by means of an arranged PQ) in view of past assurances given about the use of these powers: no new legislation will be required. I would also wish to make clear that this change does not mean that there will be any relaxation in the general standards applied by ECGD in underwriting business in other markets. It is important that the risks involved in guaranteeing these new credits should not impinge on ECGD's normal trading operations. I understand that you are willing to agree to an arrangement whereby credits given to an approved debtor country before its return to full economic health will be carried under a special sub-head of ECGD's Section 2 account, and that if any losses should arise - and I naturally hope that they will not - these will be carried by the Exchequer and will not, therefore, lead to premium increases which will affect the competitiveness of British exports to other markets. I should be grateful if you would confirm this if you and others are able to support these proposals.

4 I am sending a copy of this letter to the Prime Minister, the Secretaries of State for Foreign & Commonwealth Affairs and Defence, the Minister for Overseas Development and Sir Robert Armstrong.

Yours
Norman

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REVIEW OF ECGD POLICY TOWARDS DEBT RESCHEDULING COUNTRIES

Introduction

1 The policy which is applied by ECGD following a restructuring of official debts guaranteed by the Department has been reviewed by officials in interested Departments (ECGD, Treasury, DTI, FCO, Bank of England and Cabinet Office under the chairmanship of Mr Unwin (Treasury). A change in this policy to allow ECGD support to be given for new credits to certain "deserving" countries is recommended unanimously as set out below.

Background - present policy

2 Like most other official export credit agencies ECGD withdraws cover for new credits when it is evident that a debtor country is to seek a Paris Club restructuring of its official debt (or is to seek such relief outside the formal auspices of the Paris Club). In practice cover is automatically withdrawn for similar credits for new business, (thus for example when Mexico rescheduled its ECGD guaranteed private sector Medium Term debts, cover was still maintained for public sector Medium Term and all Short Term transactions). Such cover is only restored after a "convalescent period" when in the view of the Export Guarantees Committee, the debtor country's creditworthiness has been clearly re-established. The current criteria for the resumption of cover (and the arguments for the maintenance of the present strict policy) are detailed in Appendix 1 attached. No exceptions to current rules have been agreed, (despite considerable trade and political pressure for exceptions to be made for some countries, eg Brazil, Peru, Ecuador, Mozambique and Malawi).

Case for some relaxation of current policy

3 The main arguments for some controlled relaxation of existing policy are as follows:-

a The need to find some means of rewarding those developing countries prepared to take tough measures in conjunction with the IMF.

b The growing evidence that for political and economic reasons other governments are offering new credits to favoured debtor countries; thus the UK is in danger of being isolated because ECGD insists on a "convalescent period" of 2 years or more following the debt rescheduling, whereas other agencies resume cover at an earlier stage.

c The fact that many major export markets are now joining the list of countries with debt service problems and default by these could threaten the international monetary system.

d The heavy short term debt burden of some rescheduling countries (which is so severe that they cannot even pay cash for essential imports needed to maintain the basic productive capacity of the economy).

e The need to prevent over-reaction from private lenders anxious to reduce their current exposures.

f The need to assist UK industry to maintain a stake in significant export markets which seem likely to be able to re-establish themselves as reliable trading partners.

g Wider political and strategic considerations.

Recent developments

4 The main developments in the situation are:-

i The list of rescheduling countries continues to grow and now includes many important trading partners (see Appendix 2). HMG has a very considerable financial interest in seeing these countries nursed back to health as ECGD's existing exposure on them amounts to approximately £6,500m and total UK exports to them in the last year prior to the debt restructuring amounted to over £1,900m.

ii Further evidence that other creditor governments are being more flexible in their approach. It would now appear that the UK is alone among all the major creditor governments in consistently refusing to provide further cover for a period after the approach to the Paris Club. The stated policy of other agencies is described in Appendix 3. There is some ambivalence in the position of a number of our competitors and it has to be accepted that many are not following a consistent policy, but are prepared to make exceptions to a generally restrictive policy where a close political or trading partner is involved. The policy of major creditor countries is briefly as follows:-

USA and Canada - normally maintain cover if an IMF adjustment programme is concluded (believing that the debtor country's prospects have been improved and it is essential to maintain flow of credits to assist the economic recovery);

France, Italy & Spain - frequently support further credits for pragmatic reasons;

FRG, Japan and Sweden - are fairly restrictive but have all agreed to cover new credits exceptionally during the past year.

In practice 15 countries have offered to cover new credits to Yugoslavia (whilst under existing rules the resumption of ECGD Medium Term cover cannot be considered).

iii Pressure from the debtor countries and the IMF has also been increasing. Many debtor countries have been seeking assurances of new credits at the same time as they approach the Paris Club for rescheduling (and Latin American countries are seeking this as part of the Cartagena decision). The IMF generally associates itself with the US government view that maintenance of official export credit support is a crucial and legitimate part of the economic recovery plan and seems likely to press that official export credits should be made available in deserving cases where the debtor country is making strenuous efforts to adhere to a stabilisation programme worked out with the Fund.

Possible Basis for Future Policy

5 In order to sharpen the distinction between the responsible and irresponsible debtor countries and to prevent UK from being isolated (which could be to our future trading and political disadvantage), it is recommended that HMG should establish a capacity to provide new credits to a debtor country which is making strenuous efforts to effect an economic recovery. It is proposed that such support

would have to be agreed selectively on a case-by-case basis and would only be considered if all of the following pre-conditions have been met:-

1 the debtor is committed to a strong IMF stabilisation programme which would justify the multilateral rescheduling of official debts;

2 the stabilisation programme offers a reasonable prospect that the new debt service commitments will be honoured and current payments are being made satisfactorily; and

3 other governments are committed to offer similar support on an acceptable burden sharing basis.

It is proposed that - at least until some experience has been acquired - such cover would be subject to specific Ministerial approval. It would be provided by ECGD using its Section 2 (national interest powers).

6 The conditions on which ECGD support would then be made available in appropriate cases would normally be based on the following guidelines:-

A No irrevocable commitment to provide new cover should be given until after the IMF programme has been approved and the multilateral debt rescheduling negotiations have been completed.

B Provision should be made for the suspension of cover in the event that the debtor country is in breach of its obligations under the rescheduling or IMF agreements.

C New cover should normally be pitched so as to sustain trade at a significantly lower level than prior to the debt rescheduling.

D Wherever possible, commercial interest rates should be charged both under the rescheduling agreement and for the new credits, (exceptions may have to be made where this was clearly beyond the debt service capacity of the importing country, but in any event operating administrative costs should be recouped).

E Cover should be tied to imports of UK goods and services contributing to the economic recovery programme or the immediate welfare of the debtor country.

F As far as possible, the credit terms should be tailored so that repayments fall outside the most critical years for debt service payments.

G New cover for project business should be given only exceptionally for key projects vital to economic rehabilitation and given the IMF/IBRD seal of approval, (and preferably where the risks are being shared with other governments or the IBRD, IDB or similar international institutions).

7 It is hoped that as a corollary to the adoption in the future of a more liberal policy towards the resumption of cover on debt rescheduling countries as recommended above, it might be possible to take a harder line on the maintenance of cover on other countries drifting into difficulties. However, it has to be recognised that without any system of co-ordinated action with other major exporting countries, such early avoidance of future debt service problems is difficult to achieve taking into account the highly competitive situation in export markets.

Accounting Responsibility

8 No new legislation would be required as cover would form part of ECGD's Section 2 operation. However, as the provision of new cover, even on the carefully controlled basis set out above, would involve high risks on countries with heavy debt burdens, it is proposed that liabilities for such credits should be shown separately in ECGD's Section 2 accounts until such time as the economic health of the debtor country has been restored to a state which permits ECGD cover to be provided on the basis of normal underwriting criteria. During this convalescent period any losses would be borne by the Exchequer and consequently would not lead to pressure on ECGD to raise its premium charges for exports to other markets. It will be necessary for a Trade Minister to make a statement to the House:-

a to avoid any conflict with previous assurances that the House would be informed of any unusual use of ECGD's Section 2 powers, and

b to make clear that this change of policy does not represent any general lowering of ECGD's standards of country assessment.

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Appendix 1

ECGD POLICY TOWARDS RESCHEDULING COUNTRIES

CURRENT CRITERIA FOR RESUMPTION OF COVER

1 Before restoring cover the EGC would normally expect that most of the following conditions should have been satisfied:-

A The bilateral agreement covering the rescheduling of guaranteed debt should be in force.

B The satisfactory performance of its obligations by the debtor country should have been demonstrated over an adequate period.

C There should be no prospect of a further major rescheduling of debt.

D There should be no delays in payment for current commercial imports.

E Our assessment of balance of payments prospects should provide a reasonable assurance that future debt service obligations will be honoured.

F The debtor country should be complying with the conditions of any stabilisation programme agreed with the IMF.

G The political situation should be stable and the general management of the economy adequate.

CASE AGAINST ANY RELAXATION OF POLICY

2 The main arguments for the maintenance of the current restrictive policy are briefly as follows:-

a the need to maintain international financial discipline;

b the risk of a general degeneration of credit terms;

c the implications for the balance of payments and on ECGD's own finances;

d the reluctance to provide "double relief" (as the deferment of existing debt should enable trade to continue on a cash basis).

Most of these arguments continue to have validity and if a rescheduling becomes too easy an option there is a real risk of proliferation. Moreover it now seems that an impetus towards softer credit terms will arise not only from the extensions involved in the rescheduling operation itself, but also because Medium Term credits will be sought for imports of essential industrial raw materials, food etc. which are normally sold on cash or Short Term credit, thus making it more difficult to hold to traditional terms in more creditworthy markets. It should be noted that in addition to the above policy arguments, there is a legal constraint which would prevent ECGD covering new credits maturing within the consolidation period under the rescheduling agreement. This would be barred by the simple common law principle that insurance cannot be given against a certainty. Thus if debts falling due in 1984 have been rescheduled. ECGD cannot cover new credits maturing in that year if there is a likelihood of the cut-off date for contracts covered by the consolidation being rolled forward. However this legal obstacle could normally be circumvented, as payments maturing in later years could be insured.

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ECGD - LIST OF RESCHEDULING COUNTRIES - SUMMARY

Country	Debt ø Consolidated	Cover withdrawn	Cover restored	UK annual exports before rescheduling ≠
				(£m)
a Running agreements				
1 Central African Rep	MT 1980/81	7/80	Not yet	7.74
2 Costa Rica	MT 1982/83	8/81	" "	5.45
3 Cuba	MT 1982/83	1/83	" "	64.45
4 Ghana	MT 1972/74	4/71	" "	87.85
5 Guinea Rep	MT 1968/76	9/67	" "	3.64
6 Indonesia	MT 1966/72	5/67	Yes in 8/71 Case-by-case, then 2/72 gen.	5.9 (1965)
7 Liberia*	MT 1980/84	5/80	Not yet	46.35
8 Madagascar*	ST & MT 1980/84	2/81	" "	11.82
9 Malawi*	MT(public)82/84	7/82	" "	20.85
10 Peru (1)	MT 1979	10/78	Yes in 11/79	
(2)	MT 1983/84	7/83	Not yet	39.4
11 Poland	MT 1981	1/82	" "	296.16
12 Romania	MT 1982/83	9/81	" "	150.26
13 Senegal *	MT 1981/83	11/81	" "	26.28
14 Sierra Leone (1)	MT 1975/78	3/76	" "	21.10
(2)*	MT 1979/84	3/79	" "	
15 Sudan*	ST & MT 1979/84	4/80	" "	114.08
16 Togo	MT 1979/83	5/79	" "	18.16
17 Turkey	ST & MT 1979/83	9/77	Yes in 7/83	211.44
18 Uganda	MT 1981/83	7/76	Not yet	27.20
19 Zaire	ST & MT 1975/84	5/75	" "	23.61
20 Zambia	ST & MT 1982/83	4/79	" "	68.22
21 Yugoslavia	MT 1983/84	9/81	" "	158.84
b Awaiting signature				
22 Ecuador	MT 1983/84	7/83	" "	60.78
23 Mexico	ST & MT(Private) 1983	5/83	" "	162.91
24 Morocco	MT 1983/84	9/83	" "	95.46
25 Niger Rep.	MT 1983/84	9/83	" "	17.44
c Under negotiation				
26 Brazil	MT 1983/84	8/83	" "	158.77
27 Ivory Coast	MT 1984	2/84	" "	25.59

NOTES
* Includes further agreement currently in negotiation or awaiting signature;
ø Shows years covered by all or part of the consolidation;
≠ Figures given are for last full year prior to the current rescheduling and therefore relate to different years.

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Appendix 3

OTHER GOVERNMENTS STATED POLICY TOWARDS RESCHEDULING COUNTRIES

The following table is based on the statements made by OECD representatives at the Export Credit Group Meeting in May 1984 supplemented by further bilateral discussions between ECGD and their counterparts.

I WITHDRAWAL OF COVER

Nearly all official export credit agencies withdraw cover for new credits following an application by the debtor country to the Paris Club (or an equivalent body). The major exceptions here are the USA and Japan. The US Eximbank frequently regards the approach as a welcome sign and offers new credits to offset any curtailment in US bank lending. Normally these are not confirmed until after the IMF programme has been approved by the Board but it is significant that in the case of the Philippines Eximbank/FCIA cover is being maintained even though agreement has not been reached on an IMF programme. Japan is exceptional in that cover is not formally withdrawn until after signature of the Paris Club multilateral agreement(but we understand that in practice very little additional exposure is accepted during the negotiating period.)

II RESUMPTION OF COVER

A Cover resumed prior to signature of Paris Club/bilateral rescheduling Agreements

USA/Eximbank, FCIA	Generally cover is not totally withdrawn but in any event it is resumed on a case-by-case basis provided debtor country is in compliance with the IMF programme.* US Government believes that countries with liquidity problems should not have access to export credit facilities closed.

B Cover resumed once Paris Club/bilateral agreements concluded

AUSTRIA/OKB	Yes, but on a restricted basis*.
CANADA/EDC	Not automatic,* take into consideration immediate and long term creditworthiness of debtor country as well as need to sustain international liquidity and Canadian exports.
GERMANY/HERMES	Consider reinstatement of cover but look at following factors: i economic outlook; ii willingness and ability of country to meet obligations under rescheduling agreement.*
ITALY/SACE	Yes, but on informal basis, ie case-by-case.*
NETHERLANDS/NCM	Similar policy to Germany.*

Appendix 3 (Continued)

SPAIN/CESCE	Normally resume cover subject to some form of ceiling but if country's economic position very poor, will await positive experience under rescheduling agreement. However, if close commercial relations exist, resume cover straight away after Paris Club agreement concluded.

C Cover resumed when clear that IMF programme is being implemented

BELGIUM/OND	Yes.*
FINLAND/VTL	Resumption of medium term cover is generally on a gradual basis.*
FRANCE/COFACE	Resume cover on case-by-case basis, taking into account debtor country's willingness to implement IMF measures.*
JAPAN/MITI	All cover withdrawn (ie both ST and MT) for a period and resumed on cautious basis, ie case-by-case.*

D Cover resumed when clear that both IMF and bilateral agreements are being honoured

DENMARK/EKR	Normally want to see some payments being received under the rescheduling agreement. For countries with more than one rescheduling stay off cover for longer period.* But policy under review.
AUSTRALIA/EFIC	Resume cover on restrictive basis for traditional trade.*
PORTUGAL/COSEC	Generally with reduced commitment limit and for short term business only.
SWITZERLAND/GERG	Normally resume once seen that agreement has been adhered to for some time.*
UK/ECGD	Consider resumption when seen how debtor country is complying with Paris Club and IMF programmes.

*NB There is evidence that in practice a more liberal policy is being applied than the stated policy given here in selective cases where important political/trading relationships are involved, (eg all of these countries agreed to offer export credits to Yugoslavia as part of the IMF package, the USA is maintaining cover with the Philippines where conclusion of the IMF negotiations has still not been reached, and Japan has also recently offered new MT credits to Brazil).

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