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Fact Sheet for the
Honorable Patrick Leahy, U.S. Senate

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# CENTRAL AMERICA AID

# Status of the Trade Credit Insurance Program

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UNITED STATES GENERAL ACCOUNTING OFFICE
WASHINGTON, D.C. 20548

NATIONAL SECURITY AND
INTERNATIONAL AFFAIRS DIVISION

December 31, 1985

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The Honorable Patrick Leahy
United States Senate

Dear Senator Leahy:

As arranged with your office, we are providing this fact sheet on how the Trade Credit Insurance Program (TCIP) is used, controlled, and funded. This program, administered jointly by the Agency for International Development (AID) and the Export-Import Bank (EXIMBANK), guarantees repayment of U.S. commercial credit to finance Central American imports of U.S. goods and services for use by the private sector. We obtained this information from August to December 1985 as part of our overall review of AID's Central American regional program, which we are conducting at your request.

As of December 1985, about $27 million of credit commitments had been made under the program, less than 9 percent of the $300 million credit-guarantee ceiling established for the program. AID and EXIMBANK attributed the limited program use to a variety of factors including start-up difficulties, host-country central bank procedures, limited demand for raw materials and spare parts needed by the private sector as components to production for export, and private sector reluctance to incur dollar-denominated debt due to fears of local currency devaluation.

AID and EXIMBANK did not have data on the specific products imported under the program except in Honduras. In that country, most of the items imported were being used as components in producing goods for domestic consumption, but some were ineligible consumer goods. AID officials explained that they have relied on host-country central banks to control TCIP use and have sought to avoid complex procedures which could impede program implementation.

AID designed the TCIP to be self-sustaining with host-country banks guaranteeing repayment on all transactions. However, as a precautionary measure, AID set aside $60 million in fiscal year 1985 for a bad debt reserve. In September 1985, AID reprogrammed $50 million of this amount for other purposes. For fiscal year 1986, AID requested $40 million for the bad debt reserve.

Assuming that most of these reserve funds will not be needed to pay for TCIP bad debts, AID plans to reprogram a portion for other purposes late in fiscal year 1986, as it did with the fiscal year 1985 funds.

At this point in our work, we have not reached any final conclusions about the need for reserve funds under the TCIP. However, given that funds appropriated for the reserve in fiscal year 1985 were reprogrammed and program use has been limited, there are questions about the need for a reserve. In view of these questions, we intend to monitor AID requests for funds under this program and to continue our overall evaluation of program implementation.

We reviewed the TCIP at AID and EXIMBANK in six Central American countries. Our fieldwork included discussions with AID mission officials and host-country central bank officials where applicable. We did not obtain official agency comments but we did discuss the contents of this fact sheet with AID and EXIMBANK officials and their views were considered in preparing this document.

As agreed with your office, we are sending copies of this fact sheet to AID, EXIMBANK, appropriate congressional committees, and other interested parties upon request. If we can be of further assistance in this matter, please call Mr. Joseph E. Kelley, Associate Director, at 275-5790.

Sincerely yours,

Frank C. Conahan

Frank C. Conahan
Director

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## ABBREVIATIONS

| | |
|---|---|
| AID | Agency for International Development |
| EXIMBANK | Export-Import Bank of the United States |
| TCIP | Trade Credit Insurance Program |

# STATUS OF THE TRADE CREDIT INSURANCE PROGRAM

## PROGRAM HISTORY

The Trade Credit Insurance Program (TCIP) was established in fiscal year 1985 to provide U.S. government guarantees to support U.S. exports of goods and services to the private sector in Central America. The program is a joint effort of the Agency for International Development (AID) and the Export-Import Bank of the United States (EXIMBANK).

The TCIP was originally considered in 1982 as part of the Caribbean Basin Initiative, but the idea was dropped primarily because it would cause the U.S. government to incur additional contingent liabilities. In January 1984, the National Bipartisan Commission on Central America recommended that new official trade credit guarantees be made available to the Central American countries because it believed that a decline of trade credits had critically affected the flow of imports into Central America. In October 1984, Public Law 98-173 added section 224 to the Foreign Assistance Act of 1961, as amended, which provides legislative authority for the program. AID and EXIMBANK announced establishment of the program in December 1984.

## AID'S FUNDING REQUESTS

AID set aside $60 million of fiscal year 1985 funds as a bad debt reserve for $300 million of short-term trade credit guarantees. AID has requested an additional $40 million of fiscal year 1986 funds for a bad debt reserve and $200 million of additional trade credit guarantee authority.

AID initially indicated its plans for the TCIP in the fiscal year 1985 Congressional Presentation on its Central American regional program. AID did not request any appropriations for the TCIP at that time. Instead, AID said the reserve fund for potential bad debts under the TCIP would come from monies included in the individual country requests for Economic Support Funds. One year later in another Congressional Presentation, AID said that $60 million of regional program resources would be used as a reserve fund. Should the full amount of the reserve not be needed, these funds would be reprogrammed for other purposes.

To continue the TCIP, AID requested an additional $40 million in its Congressional Presentation for 1986 on its Central America regional program. These funds were for a bad debt reserve for an additional $200 million in trade credit guarantee authority that AID sought. In March 1985, the AID Administrator said he anticipated that the TCIP would be needed for only fiscal years 1985 and 1986. However, AID's Latin America Bureau currently plans to request additional guarantee authority and funds for a bad debt reserve for fiscal year 1987.

## PROGRAM MECHANICS

EXIMBANK administers the technical aspects of the program, and AID provides funds to reimburse EXIMBANK for any credit guaranteed by EXIMBANK that is not repaid. AID explained that it designed the program to minimize the administrative burden on AID/Washington and the AID missions.

In general terms, the TCIP was to operate as follows.

- --AID would allocate an amount of guaranteed credit for a recipient country and would increase the allocation based on demand.
- --AID would enter into agreements with the recipient country central banks which would select the participating commercial banks in their respective countries and negotiate short-term U.S. dollar denominated credit lines (less than 1 year) with U.S. commercial banks.
- --EXIMBANK, through its agent, the Foreign Credit Insurance Association in New York, would insure repayments of credit for specific sales of U.S. goods and services to the private sector in Central America.
- --Recipient country central banks would be first guarantors of repayment on all TCIP transactions.
- --AID would reimburse EXIMBANK for any losses due to bad debts under the program.

## PROGRAM USE

According to legislation, the TCIP is to be used to finance transactions involving the export of goods and services for the use of the private sector in Central American countries. The legislation does not specify the types of products or services eligible under the program. EXIMBANK indicated in late 1984 that non-military goods and services of U.S. origin for use in the Central American private sector would be eligible under the TCIP. Examples of eligible items cited by EXIMBANK were spare parts, raw materials, and agricultural products. In its fiscal year 1986 Congressional Presentation, AID reported that "the TCIP will increase credit to finance inputs for agricultural and industrial production which, in turn, will generate employment, increase production and help earn sorely needed foreign exchange."

AID signed TCIP agreements with Honduras, El Salvador, Costa Rica and Belize in February 1985 and signed an agreement with Guatemala in March. These agreements generally describe the credit arrangements to be made by AID, EXIMBANK, U.S. banks, and host-country banking systems. In addition, the agreements provide general guidance on program use and product categories eligible under the program.

EXIMBANK issued insurance coverage for Honduras, El Salvador, and Costa Rica in April. Eximbank authorized insurance coverage for Guatemala in August and is in the process of issuing coverage. Insurance coverage for Belize has not been issued. In April 1985, AID reported that no product shipments had taken place, but that shipments would begin within the next few weeks. As of July 1985, EXIMBANK data showed that $4.1 million in credit commitments had been made and $2.3 million in goods shipped. Start-up difficulties and the logistics of explaining the program to participating banks were given as reasons for the low initial use.

On December 17, 1985, EXIMBANK provided the TCIP use data shown in table 1. This data indicates that use of the TCIP has increased since July 1985, but is less than 9 percent of the $300 million credit guarantee ceiling established for the 1985 program.

Table 1
TCIP Use Data
(As of December 1985)

| Country | Credit allocations | Insurance issued | Commercial bank credit commitments | Goods actually shipped |
|---|---|---|---|---|
| | | (millions) | | |
| Costa Rica | $100 | $ 25 | $11.0 | $10.9 |
| Honduras | 50 | 25 | 9.2 | 6.8 |
| El Salvador | 75 | 75 | 6.4 | 2.7 |
| Guatemala | 25 | - | - | - |
| Belize | 5 | - | - | - |
| Unallocated | 45 | ([a]) | ([a]) | ([a]) |
| Totals | $300 | $125 | $26.6 | $20.4 |

[a]Not applicable.
Source: EXIMBANK.

According to an AID-contracted study completed in July 1985, there is limited demand for raw materials and spare parts needed by Central American producers as inputs for non-traditional export products. (AID officials told us there was also limited demand for imported raw materials and spare parts for traditional export producers.) Further, this study found that reluctance to incur dollar-denominated debt was a major constraint to private sector demand for dollar credits. That is, the private sector wishes to avoid debts which must be repaid in dollars because it fears that currency devaluation could substantially increase the cost of future dollars. Also, the study found that other short-term credit lines already existed in Central America.

According to AID and EXIMBANK officials, these constraints on demand and country-specific factors, such as central bank requirements, have limited the use of the program. These factors are discussed in the country recaps, starting on page 6.

## PROGRAM CONTROLS

EXIMBANK explained that it intended the TCIP to be used for critical imports. However, it has not attempted to control the products supported by the TCIP and has operated the TCIP the same as its regular credit guarantee programs. AID also explained that it has not attempted to independently control the types of products imported into Central America under the program. AID sought to avoid complex and potentially cumbersome control procedures which could impede implementation. Instead, AID pursued agreements with the central banks to use the TCIP for imported goods for use by the private sector and to target TCIP, to the extent practicable, to those entities producing for export. AID and EXIMBANK assumed that the central banks would direct the TCIP to productive uses in order to ensure that the importers would be able to make repayments.

During our field work, AID's Central American missions indicated that they did not see it as their role to control the import transactions financed under the TCIP. The mission in El Salvador, however, had requested the central bank to submit a report on all TCIP transactions as of October 30, 1985. This report had not been received at the time of our visit in early November 1985. In Honduras, the mission had researched TCIP transactions to answer an AID/Washington inquiry received around November 1, 1985. However, the mission believed this was EXIMBANK's responsibility and did not have sufficient time to monitor all transactions on an ongoing basis. During our fieldwork in Costa Rica, we found that the mission had no information on goods imported under the TCIP but, at the request of AID/Washington, did review selected transactions in late November 1985.

On December 10, 1985, AID directed its Central American missions to designate a TCIP officer to submit reports on TCIP activity and on central bank measures in place or planned to ensure that products shipped under the program are for private sector production.

## PRODUCTS IMPORTED

At our request, EXIMBANK obtained copies of documents submitted by U.S. commercial banks to the Foreign Credit Insurance Association, which if filled out properly, would provide information on the types of goods sold to Central America under the TCIP since the inception of the program. Of the documents available in early October 1985, some lacked any information on the specific goods and services involved. The documents that did have some product information all involved Honduran purchases; they indicated that some imported products appeared to be consumer goods rather than raw materials, spare parts, or other productive inputs which AID had expected would be imported under the program.

Closer examination of transactions during our field work and discussions with the AID mission and central bank in Honduras indicated that very few imported items were being used as inputs to production for export. Most of the items imported were being used as components for production of goods for domestic consumption, such as orange juice concentrate to be mixed with locally produced juice, metal parts for mops, base for chewing gum, large bags of oatmeal for repackaging, and snaps and clasps used in making bluejeans. In addition, imported items included 496 Spanish Bibles and bathroom accessories, including 20 bidets and toilet paper rolls, which AID believed should not be financed under the TCIP.

AID officials told us that there is no indication that critical imports have not received priority under the program. Further, AID believes that the TCIP financed shipments which do not conform to AID/central bank agreements are few in number and represent a small percentage of the items shipped. AID, the missions, and EXIMBANK have no information on products sold to Costa Rica and El Salvador under the TCIP, so we do not know what products have been imported in these countries. As previously discussed, no imports have been made by other countries under the TCIP.

## FUNDING REQUIREMENTS AND CONTINGENT LIABILITY

AID initially set aside $60 million for a TCIP bad debt reserve in fiscal year 1985. At the end of the fiscal year, AID reprogrammed $50 million of this amount for other purposes. An AID official told us that $10 million was retained in the reserve fund on a somewhat arbitrary basis, but that it should be sufficient to cover any bad debts which might occur before AID is able to replenish its reserve fund with monies requested for fiscal year 1986. If the reserve fund is inadequate, AID would have to use other resources to pay its liabilities.

The 1985 program will be in effect until April 30, 1986, in El Salvador and Honduras, May 15, 1986 in Costa Rica, and August 31, 1986, in Guatemala. If TCIP use were to accelerate, AID could have contingent liability for up to $255 million of credit extended under existing credit allocations.

As noted earlier, the Central American central banks are required to serve as first guarantors for TCIP transactions.

Assuming these banks meet their financial obligations, there would be no liability to EXIMBANK and therefore no liability for AID to repay EXIMBANK for any losses. In addition, AID, through its bilateral programs, is providing cash transfer assistance to each of the Central American governments that participate in the TCIP; the central banks could have access to Economic Support Fund dollars to pay off any bad debts. Therefore, AID expects that the TCIP will be self-sustaining and that payments from the TCIP reserve fund will not be necessary.

However, AID has requested $40 million in fiscal year 1986 to cover potential liabilities which could occur in a worst-case scenario, where central banks refuse or are unable to meet their financial commitments under the TCIP. Assuming that most of these reserve funds will not be needed to pay for TCIP bad debts, AID plans to reprogram a portion of this amount for other purposes later in fiscal year 1986, as it did with the fiscal year 1985 funds.

## COUNTRY RECAPS

The following sections summarize the status of the TCIP in each Central American country.

### Costa Rica

As of December 1985, EXIMBANK indicated that $11 million in confirmed letters of credit had been issued under the TCIP in Costa Rica out of the $100 million allocated. As of mid-November, neither AID nor EXIMBANK had information on the products imported.

Costa Rica's TCIP allocation was increased from $25 million to $100 million in September 1985. Under the first $25 million allocation, the central bank was the borrower and managed all the credit; no local commercial banks were involved. The program provided no direct credit to the private sector, as it guaranteed loans to the central bank, and local importers purchased foreign exchange from the central bank with local currency. In this way, the TCIP enabled importers to have access to foreign exchange more quickly but it did not provide them any credit. The central bank has maintained that importers in Costa Rica have sufficient local currency credit already available, but lack access to foreign exchange. Two AID mission officials questioned if Costa Rica's use of the TCIP under its first $25 million allocation was consistent with the program's intent since it provides foreign exchange but no credit to the private sector.

As of December 1985, it was not clear how the TCIP would operate in Costa Rica under the second allocation of $75 million. The central bank allocated the $75 million among five U.S.-based banks in October 1985, but it has not been determined whether the central bank will again be the borrower or whether Costa

Rican commercial banks will be involved. Thus, it is uncertain whether the program will provide credit to the private sector.

Guarantee authority for Costa Rica under the 1985 TCIP will expire on May 15, 1986.

Honduras

As of December 1985, EXIMBANK indicated that $9.2 million of confirmed letters of credit had been issued under the TCIP in Honduras. The U.S. Embassy Economic Counselor attributed the low use of the TCIP to Honduran commercial bank and importer reluctance to incur dollar-denominated debt due to fear of local currency devaluation. Further, EXIMBANK believes commercial bank reluctance to participate in the program is exacerbated by central bank procedures, which severely limit commercial bank access to foreign exchange with which to repay debts. These procedures are a result of overall foreign exchange shortages in Honduras. EXIMBANK does not anticipate full use of the $50 million credit allocation for Honduras unless additional foreign exchange becomes available. The AID mission and the Embassy Economic Counselor do not anticipate significant increase in TCIP use until an exchange rate adjustment occurs.

According to central bank officials, the TCIP has been used to import goods from the United States which previously had been imported from other Central American countries, principally Costa Rica. To date, the majority of imported goods have been inputs to production for domestic consumption. Few have been used to generate exports, apparently because there is little demand for imported inputs for export production. Further, some ineligible consumer products have been imported.

The central bank signed an amendment to its TCIP agreement in late October 1985 which stipulates that the program is to be used to the maximum extent possible to generate exports. Prior to this, there was no requirement that the program be oriented toward exports, as this clause was inadvertently dropped out of the original agreement.

Despite the new amendment, a central bank official told us in November that the bank is uncertain as to what imports are permitted under the program and needed guidance as to what items should be approved. Further, he maintained that there is little demand in Honduras for credit to import raw materials to produce exports and that if the program was limited to those items there would be little demand. The mission director and other mission staff concurred with this assessment, pointing out that most Honduran industries need few imports to produce goods for export. In the mission's view, the program should give first priority to financing those imports of raw materials which are needed to produce exports to countries outside of Central America, second priority to imports needed to produce exports to other Central American countries, and third priority to goods that would result in production for domestic consumption.

Until October 1985, there was limited oversight of the TCIP in Honduras. The Honduras mission viewed the program as being under AID/Washington and/or EXIMBANK and did not believe it was the mission's role to closely monitor the program.

AID/Washington asked that the mission look into program use in October when information surfaced about the types of goods that had been imported. (See p. 4 and 5.) On November 18, the mission informed AID/Washington that it would be impractical to require prior mission approval for each import transaction, in part, because of the added workload it would place on AID staff.

Guarantee authority for Honduras under the 1985 TCIP will expire on April 30, 1986.

El Salvador

As of December 1985, EXIMBANK indicated that $6.4 million of confirmed letters of credit had been issued under the TCIP in El Salvador out of the $75 million allocated. As of early November, neither AID nor EXIMBANK had information on the products imported under the program, although the mission had requested this information from the central bank. The AID mission attributed the limited activity to one primary factor--a government of El Salvador ceiling on external short-term credit. Salvadoran private sector reluctance to incur dollar-denominated debt due to fear of local currency devaluation could, according to the AID mission, constrain TCIP use in the future.

Because the central bank ceiling on short-term credit was reached before the TCIP began, the program is being used as a substitute for existing lines of credit as they are paid off. According to the AID mission, the TCIP is more attractive than other credit lines available to El Salvador because its interest rates are about three points lower and collateral requirements are less. If the central bank uses the entire $75 million TCIP allocation, the AID mission estimates that the bank could free up as much as $20 million in collateral deposits, which could then be made available for other purposes. The mission expects TCIP use to increase as other credit lines are paid off.

Guarantee authority for El Salvador under the 1985 TCIP will expire on April 30, 1986.

Guatemala

As of December 1985, EXIMBANK indicated that there has been no credit activity under the TCIP in Guatemala. Because the government of Guatemala had been in arrears on some prior EXIMBANK transactions, the TCIP was not authorized in Guatemala until August 1985. Since then, the central bank has signed an agreement with one U.S. bank. Guatemala's TCIP credit allocation is $25 million.

According to a central bank official, there has been no loan activity under the TCIP because the bank is waiting for a decision on whether the program can be used to import petroleum products. The bank asked AID whether the program could be used for this purpose in October 1985 but as of mid-November it claimed it had received no formal response on this request. The bank indicated that if petroleum imports were allowed, it would use its entire $25 million allocation for this purpose. Further, it would like to have its allocation increased to import petroleum products.

AID told us that the TCIP cannot be used in Guatemala for petroleum imports, and that mission officials have told the central bank that these imports are not permissible. AID officials are concerned, however, that when a newly elected government comes to power in Guatemala in January 1986, there may be external pressure on AID to allow these imports. Mission officials cited three main reasons for their opposition to petroleum imports: (1) the petroleum products would be used primarily for general domestic (including public sector) consumption rather than by the private sector as stated in the legislation and would not necessarily be used for productive purposes, (2) the central bank would most likely have difficulty repaying the short-term credits in dollars, as it would not be generating any foreign exchange from these imports, and (3) allowing the petroleum imports could conflict with one of AID's Economic Support Fund conditions--to reduce government of Guatemala subsidy of petroleum prices.

In view of a perceived lack of short-term credit in Guatemala, the mission believes there could be significant activity under the TCIP once the central bank accepts that it cannot be used to import petroleum products. The mission believed that there is substantial demand in Guatemala for fertilizer imports for agricultural production. However, the mission also pointed out that a possible constraint to program use is that potential borrowers may be reluctant to incur dollar-denominated debt because of a fear of local currency devaluation.

Guarantee authority for Guatemala under the 1985 TCIP will expire on August 31, 1986.

Belize

AID and Belize signed a TCIP agreement on February 19, 1985, and an initial credit allocation of $5 million was approved on May 30, 1985. The central bank of Belize identified the participating U.S. and Belizean commercial banks in June 1985 but has not allocated portions of the $5 million among them. According to the deputy governor of the central bank, a stand-by arrangement with the International Monetary Fund prohibits the central bank from issuing guarantees on private sector debt or borrowing on behalf of the private sector, as envisioned under the TCIP. This constraint will exist until March 31, 1986 when the stand-by arrangement expires. In addition, Belize commercial bank representatives have shown little interest in the program.

AID/Washington and EXIMBANK officials told us they doubt that the program will ever be implemented in Belize. The AID representative for Belize was less pessimistic and hopes that some use could occur later in 1986.

## Panama

In early 1984, AID anticipated that Panama would receive trade credit guarantees under the TCIP. However, in late 1984, the mission informed EXIMBANK that there was no apparent need for the TCIP in Panama. Therefore, Panama has not received a TCIP allocation. During our field work, the AID mission confirmed that the TCIP was not needed because Panama is a U.S. dollar based economy and sufficient alternative credit sources exist.

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