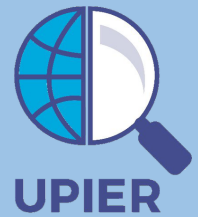

USES OF THE PAST IN INTERNATIONAL ECONOMIC RELATIONS



FROM HEATH TO THATCHER: THE ROLE OF UK FOREIGN
POLICY IN THE DEVELOPMENT OF THE EASTERN EUROPEAN
SOVEREIGN DEBT CRISIS, 1970- 81

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Abstract

The sovereign debt crisis of the 1980s was a world debt crisis which started in Eastern Europe in 1981 before spreading to other regions of the world. Yet, whilst the literature on the sovereign debt crisis in Latin America is substantial, the literature on the crisis in Eastern Europe is comparatively meagre. To date, attention has focused on the economic factors and the role of debtor countries in the development of the sovereign debt crisis during this period, whilst little has been written on the role of politics and creditor countries in this crisis. This paper seeks posit an alternative view by analysing the role of the UK as a creditor country. We find that the political strategies adopted by the Wilson/Callaghan and Thatcher governments towards Eastern European played a significant role in the development of the Eastern European sovereign debt crisis.

From Heath to Thatcher: the role of UK foreign policy in the development of the Eastern European Sovereign Debt Crisis, 1970—1981

1 – Introduction

This paper aims to illustrate how politics influenced the development of the Eastern European debt crisis from a UK government perspective. It shows that a thorough analysis of the role of politics between 1970-1981 (that is the period between Edward Heath and Margaret Thatcher's governments) is necessary to understand the UK's role in the development of the debt crisis in Eastern Europe. Archival evidence reveals that UK-Eastern European trade relations were politically motivated, particularly in the years following 1975. The paper demonstrates that the policies and initiatives of the UK government shows that it bears a greater responsibility for the development of the debt crisis in Eastern Europe than has been attributed to it in the sovereign debt literature. Thus, this paper highlights the importance of analyzing the relationship between politics and finance in the development of a sovereign debt crisis.

With the beginning of the détente, and the warming of East-West relations in the late 1960s and early 1970s, Eastern European countries adopted an import-led growth strategy in order to

industrialize their economies.¹ By using money borrowed from Western banks, in the form of sovereign loans, Eastern European countries planned to import technology for industrial development which would, in turn, enable them to export of goods to the Western market. It was anticipated that the hard currency earned from the sale of these goods would be used to pay off the sovereign loans. This failed to come about and within a decade the import-led growth strategy would prove to be one of the key factors which plunged Eastern European countries into the 1981 sovereign debt crisis, albeit exacerbated by a number of international economic factors, combined with domestic developments in debtor countries.²

With only two exceptions, the mainstream secondary literature on the sovereign debt crisis is depoliticized, focusing primarily on the economic features of the crisis.³ The two exceptions are Kahler and Lienau. Kahler gives a thorough overview of the political landscape during the crisis, making reference not only to Latin America but also Africa and Eastern Europe. However, he does not go into depth on Eastern Europe, as the paper was written not long after the debt crisis occurred and access to official documents and data would have been limited at that time. Lienau examines the political aspect of sovereign debt and argues that politics is at the heart of sovereign lending and borrowing. However, her work does not focus on the Eastern European debt crisis;⁴ it is a notable omission given the fact that the crisis developed and took place in a

¹ Turner, M. J. (2010). *Britain's International Role, 1970—1991*. Basingstoke: Palgrave Macmillan. Aldcroft, D. H., and Morewood, S. (1995). *Economic change in Eastern Europe since 1918*. Aldershot, Hants, England: E. Elgar

² Aldcroft, D. H., and Morewood, S. (1995). *Economic change in Eastern Europe since 1918*. Aldershot, Hants, England: E. Elgar; Kotkin, S. (2010). The Kiss of Debt: The Eastern Bloc goes Borrowing. In: N. Ferguson, C. Maier, E. Manela, and D. Sargent. Eds., (2010). *The shock of the global: the 1970's in perspective*. Cambridge, MA: Belknap Press of Harvard University Press.

³ Manasse, P. Roubini, N. and Schimmelpfennig, A. (2003). *Predicting sovereign debt crises*. Washington: IMF; Bowe, M. and Dean, J. W. (1997). *Has the market solved the sovereign-debt crisis?* Princeton: Princeton University Press; Cline, W. R. (1995). *International debt reexamined*. Washington, DC: Institute for International Economics; Vos, R., (1994). *Debt and adjustment in the world economy: structural asymmetries in north-south interactions*. New York: St. Martin's Press; Zloch-Christy, I. (1987). *Debt problems of Eastern Europe*. New York: Cambridge University Press; Carvounis, C. C. (1984). *The debt dilemma of developing nations: issues and cases*. Westport: Quorum Books.

⁴ Lienau, O. (2014). *Rethinking Sovereign Debt: Politics, Reputation, and Legitimacy in Modern Finance*. Cambridge, MA: Harvard University Press; Kahler, M. (1985). Politics and international debt: explaining the crisis. *International Organization*, vol. 39 (03), pp.357-382.

Cold War context. This paper seeks to fill this gap in the literature by analyzing the role of UK politics from Heath to Thatcher in the development of the Eastern European sovereign debt crisis.

The first section presents an analysis of the 1970—1974 Heath government and discusses how UK government officials were in favor of improving political relations with Eastern Europe despite its focus on EEC membership taking priority. The following section analyzes how these views influenced the actions of the Wilson/Callaghan governments (1974—1979) which pursued an active policy towards Eastern Europe by increasing ministerial visits and providing generous ECGD credits on sovereign loans—initiatives that would prove germane to the development of the Eastern European sovereign debt crisis in the long run. The final part of this paper focuses on Thatcher’s first government (1979—1981) and discusses how Thatcher adopted a more assertive foreign policy towards Eastern European countries, not only through increased visits, but through the policies of differentiation and positive discrimination.

2 – State of UK relations with Eastern European countries under the Heath government (1970—1974)

Under Edward Heath’s government the UK’s political relations with Eastern European countries were less prioritized than they had been during the previous Labour government led by Harold Wilson, as the Heath government’s prime focus was on establishing closer ties with Western European countries and joining the European Economic Community (EEC).⁵ This left little time for much else in the foreign policy sphere – including investing in relations with Eastern Europe. As noted by Nicholas Henderson (former, British Ambassador to Poland): “HMG could not...take their eye off the first priority which was entry into Western Europe [the EEC] and that there

⁵T[he] N[ational] A[rchives], FCO28/1223, HMG’s policy towards the Soviet Union and Eastern Europe, letter from Nicholas Henderson (British Ambassador to Poland) to Julian Bullard (Head of the EESD), 27 May 1971; Ball, S. and Seldon, A. (Eds.). (2013). *The Heath Government 1970—74: A Reappraisal* (2nd ed.). Abingdon: Routledge

[was] simply not the ministerial time or diplomatic resources available to pay attention to the requirement of a more active policy towards Eastern Europe.”⁶

Dealing with Eastern European countries and their bureaucratic regimes was time- and resource-intensive. Eastern European countries used the frequency, and level, of political exchanges and visits as a benchmark for measuring the strength of political and economic relations with Western countries and adjusted their trade policy accordingly.⁷ This meant developing economic relations with Eastern European countries required commitment – specifically frequent political visits and contact between UK and Eastern European officials. Under Heath, the time and resources required for such matters were deemed by the UK government to be more usefully deployed supporting and conducting the EEC negotiations.⁸

In addition, the UK government was concerned that developing its relations with Eastern Europe would affect the UK’s EEC membership bid. This is evidenced in a 1971 letter from Henderson to Julian Bullard (then Head of the Eastern European and Soviet Department). Here, Henderson asserts that one of the main arguments against pursuing an active policy towards Eastern Europe was that the UK did not want to upset other Western European countries by being more involved in Eastern Europe, as there was an apprehension their governments would resent it and therefore not support the UK’s entry into the European Economic Commission, which was of more “immediate and direct concern” to the UK government.⁹

⁶ TNA, FCO28/1223, *HMG’s policy towards the Soviet Union and Eastern Europe*, letter from Nicholas Henderson (British Ambassador to Poland) to Julian Bullard (Head of the EESD), 27 May 1971.

⁷ TNA, FCO49/498, *Relations with the Soviet Union and East Europe Problem*, letter from Julian L. Bullard (Head of the EESD) to Sir John Killick (Deputy to the Permanent Under-Secretary at the FCO), 21 March 1974.

⁸ TNA, FCO28/1675, Cabinet Defence and Oversea Policy Committee: Policy Towards the Soviet Union and Eastern Europe – Memorandum by the Secretary of State for Foreign and Commonwealth Affairs, 29 February 1972.

⁹ TNA, FCO28/1223, *HMG’s policy towards the Soviet Union and Eastern Europe*, letter from Nicholas Henderson (British Ambassador to Poland) to Julian Bullard (Head of the EESD), 27 May 1971.

Nevertheless, papers, dispatches and letters in the UK government archives illustrate that while the Heath government remained focused on EEC membership, FCO officials and British ambassadors based in Eastern Europe continued to advocate for more constructive contacts with Eastern European countries in order to spread UK and Western influence in the region, encourage them to diminish their dependence on the Soviet Union, and improve the UK's competitiveness in Eastern European markets.¹⁰ This evidence offers a fresh insight into the thinking of key figures within the UK government, providing the groundwork for shaping the course and direction of future policy towards Eastern Europe under Heath and his successors.

Once EEC membership had been achieved by mid-1972, the Heath government re-visited efforts to foster closer economic and political contacts with Eastern Europe. The idea of a 'united Europe', in which the divisions between West and Eastern Europe would be removed so that a harmonious relationship between the countries could be achieved, gained force at this time.¹¹

However, domestic political pressure related to the first oil crisis in 1973 was on the increase and, in early 1974, Britain began to experience the three-day week strikes led by the trade unions, leaving little opportunity for the Heath government to pursue this matter further. It was only during the Wilson/Callaghan and Thatcher governments of the mid-1970s and early 1980s that the UK government were able to renew its relations with Eastern Europe.

¹⁰ TNA, FCO28/1223, *HMG's policy towards the Soviet Union and Eastern Europe*, letter from Nicholas Henderson (British Ambassador to Poland) to Julian Bullard (Head of the EESD), 27 May 1971; TNA, FCO28/1521. *Trade policy towards Romania*. Despatch from Dennis Laskey (British ambassador to Romania) to Sir Alec Douglas Home (Foreign and Commonwealth secretary), 13 April 1971; TNA, FCO28/1674, *Policy towards the Soviet Union and Eastern Europe*, letter from Julian Bullard (Head of EESD) to the Private Secretary, 23 February 1972.

¹¹ TNA, FCO49/469, letter from John Wilson (British Ambassador to Hungary) to Julian Bullard (Head of EESD), 5 December 1973.

3 – Renewing UK-East European relations under Labour’s Wilson/Callaghan government (1974–1979)

The formation of Harold Wilson’s second Labour government in 1974 was the catalyst for the UK’s pursuit of pro-active political relations with Eastern Europe. It was during this time that James Callaghan, first as UK Foreign Secretary and from April 1976, as Prime Minister, came to play a decisive role in encouraging Eastern Europe to move away from the orbit of the Soviet Union. There were two primary reasons why Wilson and Callaghan wished to develop and strengthen relations with Eastern Europe. The first was the contribution that increasing trade with Eastern European countries might make to improving the state of the UK’s domestic economy. The second was related to UK foreign policy and the desire to promote European détente by extending UK influence and Western political and cultural values in Eastern European countries to counter Soviet influence.¹²

European détente is an important element in the development of the Eastern European debt crisis as it enabled the political rapprochement between East and West Europe which led to an expansion in trade between these countries. In effect, détente enabled trade in Europe and trade enabled further détente; as Kieninger (2018) puts it, “trade had a catalytic power to overcome boundaries between East and West. The economic dimension of détente was a major, yet hidden factor for Europe’s transformation and its integration across the ideological divide.”¹³

One of the high points of European détente was the Conference on Security and Cooperation in Europe (CSCE) held in Finland in 1975, in which members of the European Community (EC)

¹² TNA, FCO28/2667, Conference of HM ambassadors in Eastern Europe and the Soviet Union: First Session, Monday 17 November 1975. Item I (a): Soviet and Warsaw Pact objectives and policies in Europe after CSCE.

¹³ Kieninger, S. (2018). *The diplomacy of détente: Cooperative security policies from Helmut Schmidt to George Shultz*. Abingdon, Oxon: Routledge; Oudenaren, J. (1991). *Détente in Europe: The Soviet Union and the West since 1953*. Durham: Duke University Press

began working together on a global stage. The CSCE was a multilateral process, intended to serve as a platform for establishing lines of communication between the East and West, which offered an opportunity to further improve East-West diplomacy on an international level. It was during this conference that the EC became formally recognized as a distinct actor at the conference, thereby creating a shift from the bi-polar US- Soviet Union world order to a new tripartite configuration. The conference was valued by Eastern European countries since it provided them with an opportunity to hold bilateral talks with Western countries.¹⁴ The CSCE also inspired the UK to hold its own conference on the Soviet Union and Eastern Europe with Her Majesty's ambassadors from these regions which helped to encourage the UK government to rebuild its relationship with Eastern Europe. The Conference of HM ambassadors in Eastern Europe and the Soviet Union (hereafter referred to as the 'HM Ambassador Conference') was subsequently organized by the Wilson government in 1975 to discuss new insights regarding the way the UK government could further develop its relations with Eastern Europe and the Soviet Union.¹⁵

As Wilson's Foreign Minister, James Callaghan was instrumental in helping the UK develop its diplomatic ties with Eastern Europe through promoting trade and increasing the number of ministerial visits. Callaghan was a firm advocate of improving relations with Eastern Europe, particularly after the economic stagnation of the early 1970's under Heath.¹⁶ He saw in Eastern Europe a viable opportunity for firms to do business that would improve the economic outlook of the UK, as the country was struggling with rising unemployment, falling living standards and soaring inflation. Callaghan made an effort to increase business between Eastern Europe and the UK, as the level of trade between Eastern Europe and the UK had been low – at the time of

¹⁴ Romano, A. (2009). *From détente in Europe to European détente how the West shaped the Helsinki CSCE*. Brussels: P.I.E. Peter Lang.

¹⁵ TNA, FCO28/2667, *Conference of HM ambassadors in Eastern Europe and the Soviet Union: First Session, Monday 17 November 1975*. Item I (a): Soviet and Warsaw Pact objectives and policies in Europe after CSCE.

¹⁶ TNA, FCO28/2832, *Reflections on the Conference of Her Majesty's Ambassadors in the Soviet Union and Eastern Europe, 17-19 November 1975* by Foreign Secretary James Callaghan to His Excellency Sir Howard Smith (UK Ambassador to Moscow), 11 March 1976.

the HM Ambassador conference, UK exports to Eastern Europe represented just 2% of the UK's total exports.¹⁷

He also encouraged the creation of “healthy political relations” with Eastern European countries so that British companies could compete for business with other Western European competitors such as France and Germany.¹⁸ Callaghan conceded that dealing with Eastern European countries was time-consuming for what were often small commercial returns, but to his mind it was still worth the effort to aid “domestic recovery and employment here at home”.¹⁹

3.1 – UK-Eastern Europe ministerial visits under Wilson/Callaghan government

Eastern European governments used the level of political contacts as a barometer for deciding how to respond to Western advances. Wilson's efforts to increase ministerial visits to Eastern Europe sent an important signal regarding the UK's intentions. Lord Goronwy-Roberts, Parliamentary Under-Secretary of State for Foreign and Commonwealth Affairs, visited Czechoslovakia in April 1975; Callaghan paid a visit to Hungary and Poland in July 1975, and Harold Wilson visited Romania in September 1975. There were also visits from Eastern European leaders to the UK including: the Romanian President Nicolae Ceausescu; the Minister of Defence for Yugoslavia, as well as the Deputy Foreign Ministers from Poland, Hungary, Czechoslovakia and Bulgaria who all paid visits.²⁰ Foreign Secretary, Callaghan commented that

¹⁷ TNA, FCO28/2440, *Future Policy towards Eastern Europe* – Planning Staff paper, attached to letter from Julian Bullard (Head of EESD) to Sir Terrence Garvey (British ambassador to Moscow), 12 February 1974

¹⁸ TNA, FCO28/2667, Conference of HM Ambassadors in Eastern Europe and the Soviet Union: Third Session, Wednesday, 19 November 1975. Item III: The Instruments of British Policy; TNA, FCO28/2667, Conference of HM Ambassadors in Eastern Europe and the Soviet Union: Second Session, Tuesday, 18 November 1975. Item II: British objectives, defensive and offensive, in relation to the Soviet Union and Eastern Europe.

¹⁹ TNA, FCO28/2832, *Reflections on the Conference of Her Majesty's Ambassadors in the Soviet Union and Eastern Europe, 17-19 November 1975* by Foreign Secretary James Callaghan to His Excellency Sir Howard Smith (UK Ambassador to Moscow), 11 March 1976.

²⁰ TNA, FCO28/2667, Conference of HM Ambassadors in Eastern Europe and the Soviet Union: First Session, Monday, 17 November 1975. Item I (a): Soviet and Warsaw Pact Objectives and Policies in Europe after the GSCE.

high level visits “unlock valuable doors” and urged additional efforts to increase not only governmental contacts but also UK economic and cultural contacts with Eastern Europe.²¹

These high-level visits came at a cost – like trade negotiations with Eastern European countries, the organization and execution of ministerial visits involved a large amount of paperwork and bureaucracy, as discussed by UK government officials at the HM Ambassador Conference.²²

Peter Preston (Deputy Secretary at the Department of Trade and Industry), questioned whether dealing with Eastern European government was worth the time and effort given the level of bureaucracy involved. In his view, such high-level meetings were a waste of time that could be better devoted to more useful tasks, noting that the meetings often resulted in more demands and additional paperwork from Eastern European countries. In his words: “the Eastern Europeans had a passion for new pieces of paper, which were mostly meaningless”, citing a specific example of Poland which had requested a new cooperation agreement with the UK, despite an almost identical agreement already being in place.²³ Bryan Cartledge (Head of the Eastern European and Soviet Department) responded by stating that “the task of [UK government] officials was to do their best to see that our firms got into the markets with an equal chance, preferably with an edge. So they needed all the weapons given to our competitors – pieces of paper, favorable credit, and officials’ time.”²⁴

Moreover, ministerial visits helped to normalize political relations with Eastern European countries and improve the political landscape in Europe. These improved relations contributed to increased trade between Eastern European and the UK, as evidenced by the continued rise in

²¹ TNA, FCO28/2832, *Reflections on the Conference of Her Majesty’s Ambassadors in the Soviet Union and Eastern Europe, 17-19 November 1975* by Foreign Secretary James Callaghan to His Excellency Sir Howard Smith KCMG, UK Ambassador to Moscow, 11 March 1976.

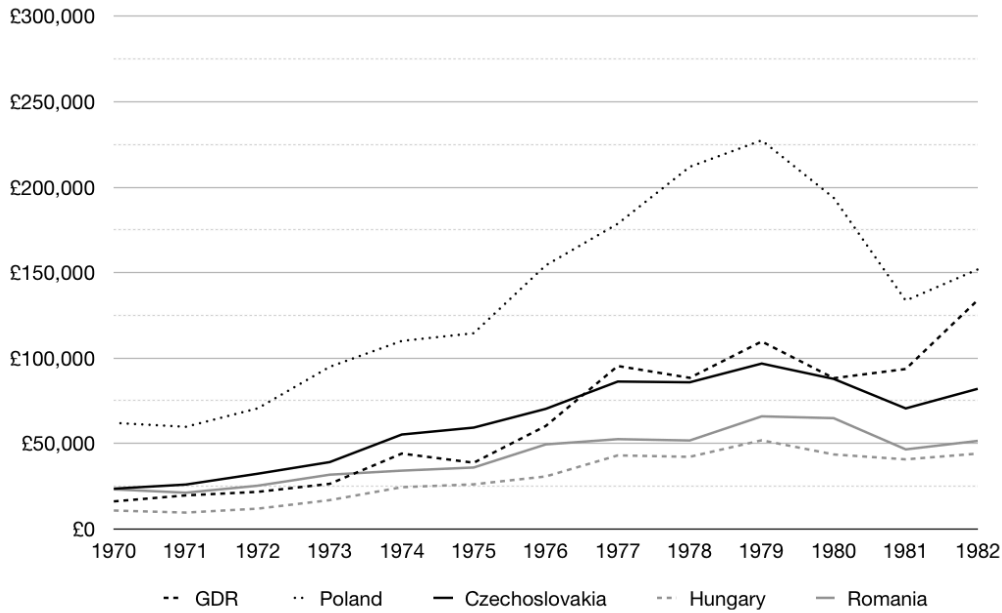
²² TNA, FCO28/2667, *Conference of HM Ambassadors in Eastern Europe and the Soviet Union: Second Session, Tuesday, 18 November 1975. Item II: British objectives, defensive and offensive, in relation to the Soviet Union and Eastern Europe.*

²³ Ibid.

²⁴ TNA, FCO28/2667, *Conference of HM Ambassadors in Eastern Europe and the Soviet Union: Second Session, Tuesday, 18 November 1975. Item II: British objectives, defensive and offensive, in relation to the Soviet Union and Eastern Europe.*

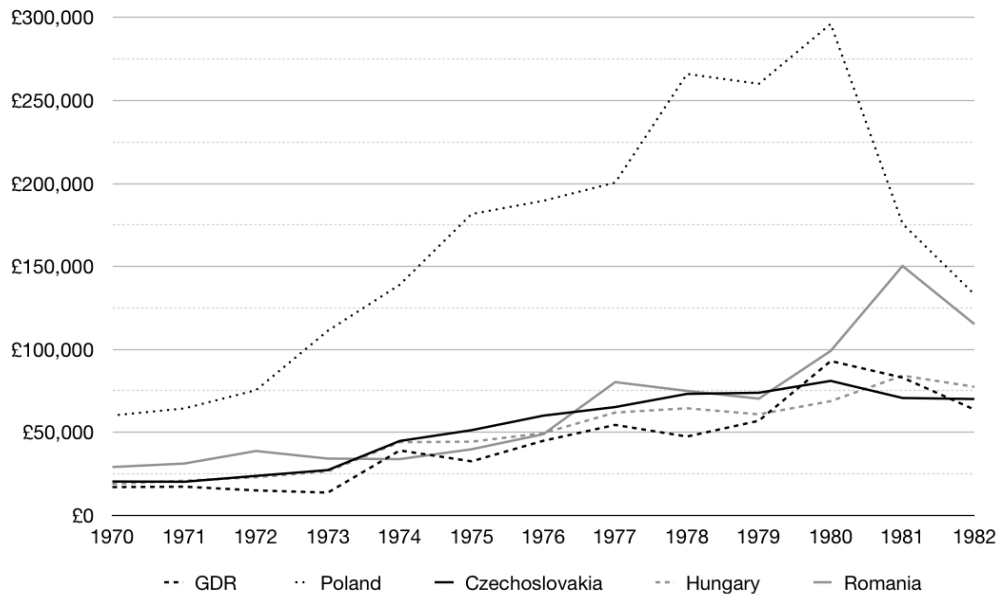
both imports to the UK from Eastern European countries and exports to Eastern European countries from the UK after 1975 illustrated figures 1 and 2 below.

Figure 1: graph illustrating UK imports from Eastern Europe between 1970 and 1982



Source: Overseas Trade Accounts of the United Kingdom 1970—1982 (London HMSO)

Figure 2: graph illustrating UK exports to Eastern Europe between 1970 and 1982



Source: Overseas Trade Accounts of the United Kingdom 1970–1982 (London HMSO)

3.2 – UK Foreign Policy in Eastern Europe

Doing business with Eastern Europe not only promised to make a contribution to the recovery UK domestic economy, it also served a useful political purpose, providing justification for the UK's involvement in the region, in the face of criticism from those who opposed it both within government and amongst the UK population. Callaghan persevered with his approach throughout his term as Prime Minister.²⁵

The additional workload of Eastern European bureaucracy could have been avoided had UK businesses been encouraged to look to other foreign markets, such as the Middle East, for trade. But the UK government regarded this as the necessary price to pursue its foreign policy goals in Eastern Europe and used trade in order to do so. The UK Department of Trade had been providing UK companies with briefings on Eastern European markets, based on diplomatic reports, but by 1975 it became increasingly involved in organizing high-level ministerial visits and joint commissions to further court Eastern European governments. The Commercial Relations and Export Division 4 (CRE4) of the Department of Trade began to offer advice to individual UK companies on Eastern European markets to promote UK business investment in the region and thereby support UK foreign policy goals in Eastern Europe.²⁶ In addition, by offering access to governmental information, UK firms would have an advantage over their Western European competitors.²⁷

²⁵ TNA, FCO28/2667, letter from Tom McNally (Political Advisor) to Bryan. G. Cartledge (Head of East European and Soviet Department, FCO), 20 November 1975.

²⁶ TNA, FCO28/2667, Conference of HM Ambassadors in Eastern Europe and the Soviet Union: Third Session, Wednesday, 19 November 1975. Item III: The Instruments of British Policy.

²⁷ TNA, FCO28/2667, Conference of HM Ambassadors in Eastern Europe and the Soviet Union: Second Session, Tuesday, 18 November 1975. Item II: British objectives, defensive and offensive, in relation to the Soviet Union and Eastern Europe; TNA, FCO28/2667, Conference of HM Ambassadors in Eastern Europe and the Soviet Union: Third Session, Wednesday, 19 November 1975. Item III: The Instruments of British Policy.

Besides this example, there is ample evidence in the archives that illustrates that the UK government made a cautious but concerted effort to encourage and support UK firms in doing business in Eastern Europe.²⁸

3.3 – Encouraging loans to Eastern Europe through Export Guaranteed Credits

In addition to courting their political leaders through official visits, the UK government provided incentives to Eastern European countries in the form of generous credit terms as loans that could be paid back over an extended period and at a low interest rate.²⁹ This was an attractive incentive for Eastern European countries, as they required money to improve and modernize their industries.

In the UK, the Export Credit Guarantee Department (ECGD) was responsible for granting these credits and had agreed to underwrite around 90 to 95 percent of any losses incurred by a UK business in Eastern Europe,³⁰ despite the fact that Eastern European countries enjoyed good credit ratings and a reliable reputation for servicing their debt.³¹ These were generous conditions: British banks and businesses were encouraged to embark on risky loans and ventures in Eastern European countries on the assumption that if bad debts occurred the UK's ECGD would bail them out.

²⁸ TNA, FCO28/4572, *Report on Romania*, from John M. Wilson (Commercial Counsellor on Romania) to A. John M. Wilson Esq (CRE 4), 28 August 1981; B[ank] o[f] E[ngland] Archives, 6A175/1, Minutes of a meeting of the Export Guarantee Committee on Friday 14 March 1980; BoE, 6A175/1, Eastern European Indebtedness, paper by ECGD, January 1980; TNA, FCO28/2667, *Conference of HM Ambassadors in Eastern Europe and the Soviet Union: Third Session, Wednesday, 19 November 1975. Item III: The Instruments of British Policy*; TNA, FCO28/2667, *Conference of HM Ambassadors in Eastern Europe and the Soviet Union: Second Session, Tuesday, 18 November 1975. Item II: British objectives, defensive and offensive, in relation to the Soviet Union and Eastern Europe*.

²⁹ TNA, FCO28/61, personal letter from Jasper Rootham (Lazard Brothers bank) to Howard F. T. Smith (FCO), 23 July 1968; Zwass, A. (2017). *Monetary Cooperation Between East and West* (2nd ed.). Oxon: Routledge Revivals.

³⁰ Winter, D. (1980). *Contracts with Eastern Europe* (2nd ed.) London: East European Trade Council.

³¹ The Banker. Vol. 128 (1): May 1978, pp. 19-21; Hansard HC Deb vol. 927 col. 1271 (8 March 1977) [Electronic version].

During the 1970–1980s, the ECGD’s credits were granted under two categories: the first was for “ordinary commercial business”, while the second covered “business which would not be covered on commercial grounds but is regarded as justified in terms of UK national interest.” Any decision, or change, regarding credits granted under category one was taken by the ECGD’s Advisory Council which met once a month for discussions. It was comprised primarily of members with an economic or financial background: bankers, exporters, commercial insurers and a representative of the Department of Trade. By contrast, credits granted under the second category were determined by the Export Guarantees Committee (EGC), a group with a largely political complexion chaired by the UK Treasury and attended by representatives from the Bank of England, the ECGD, the FCO, the Department of Trade, the Department of Industry and members of other ministerial departments, such as Defence.³²

Through the EGC, the UK government was able to exert political influence over the commercial decisions taken by the ECGD; if the UK government decided that promoting trade or lending to a particular Eastern European country was politically advantageous, it could do so by ensuring the ECGD granted guaranteed credits on a national interest basis through the EGC. So long as a country had not resorted to debt rescheduling, the EGC was allowed to address an application for credit guarantee on a case-by-case basis and grant permission for a line of credit with a UK bank so that a certain amount of “officially-insured trade” could take place.³³

Even when the financial climate changed, and Eastern European countries began to struggle with increasing indebtedness, the UK government continued to offer guaranteed credit to UK businesses and banks to encourage lending to Eastern Europe. The UK government had begun to monitor the increasing level of Eastern European indebtedness as early as 1977. This is evidenced by John Tomlinson (Parliamentary Secretary to the Ministry of Overseas

³² BoE, 3A143/1, *withdrawal of ECGD cover*, letter from J. W. Anderson (Policy and Markets, Development and Export Finance) to D. G. Holland (BoE Chief Adviser International Division), 20 March 1980.

³³ *Ibid.*

Development) in a discussion in which he confirms that the UK government was monitoring the debt build-up in the region, alongside other Western countries.³⁴

By guaranteeing credit to Eastern European countries, the UK government was encouraging continued bank lending to these countries, compounding their indebtedness. Allowing them to access ECGD-backed credits gave British banks an additional source of low-risk lending to the region. In a letter on Eastern Europe from Julian Philip Gerard Wathen (Barclays General Manager London) to Alexander Tweedie (Barclays Banker), Wathen asks what the percentage of ECGD backed credit provided by Barclays to Eastern Europe is in comparison to the total amount of ECGD finance, and queries whether Barclays could increase this percentage.

“Perhaps we could wrest more mileage out of ECGD help to Eastern Europe” he suggests.³⁵

Lloyds Bank International’s report and accounts of 1975 also highlights the role of export credit guarantees in its lending strategy, noting that the bank had made various financial packages available to Eastern Europe through ECGD-guaranteed finance and also eurocurrency medium-term lending.³⁶

The UK government had no system to evaluate, or quantify, how such ECGD credit would benefit the UK economy. This is evidenced by Preston, who states that the UK government “did not have a good system for evaluating the national benefit of such terms”. He also asserts that the use of ECGD credits could come at a high price by stating that “the terms of the Agreement with the USSR had not been all that cheap, and we had been obliged to match what the French

³⁴ Hansard HC Deb vol. 925 col. 49 (31 January 1977) [Electronic version].

³⁵ Barclays Group Archives: 80/6127. *Eastern Europe*. Letter from Julian Philip Gerard Wathen (Barclays General Manager London) to Alexander Tweedie (Barclays Banker), 23 October 1973.

³⁶ RBS Group Archives: Lloyds Bank International Limited 1975 Report and Accounts. Review of operations: Eastern Europe

had done.”³⁷ Preston questioned whether the UK government should provide cheap credit to Eastern Europe. He felt that it should be more critical of bank lending and queried whether too much had already been lent. Was it right, he asked, for the UK government to encourage British firms towards greater industrial cooperation with Eastern European countries, given the growing possibility that they could get into trouble?³⁸

It is clear that under Wilson and Callaghan, the UK government encouragement of UK businesses and banks to invest in Eastern Europe (through providing officially backed credits with generous terms on low interest sovereign loans, while increasing political relations in an effort to boost UK trade with the region) helped to foster an environment germane to the development of the Eastern European sovereign debt crisis. Nevertheless, further innovations to the UK’s approach towards Eastern Europe were just over the horizon and, under a new Conservative Prime Minister, were about to stimulate ongoing lending during the next decade.

4 – Differentiation, discrimination and debt: Thatcher’s renewed policies on Eastern Europe (1979–1981)

With the election of Margaret Thatcher in 1979, the UK government assumed a more assertive role in foreign affairs, especially with regards to policy on Eastern Europe and the Soviet Union.³⁹ The UK government wanted to be seen as a unique voice in Eastern Europe, with a new approach based on the development of the policies of differentiation and positive discrimination. These twin policies were employed as a tool to undermine the influence of the Soviet Union in Eastern Europe and, through the dissemination of Western ideas and values,

³⁷ TNA, FCO28/2667, Conference of HM Ambassadors in Eastern Europe and the Soviet Union: Second Session, Tuesday, 18 November 1975. Item II: British objectives, defensive and offensive, in relation to the Soviet Union and Eastern Europe.

³⁸ Ibid.

³⁹ Heppell, T. (Ed.). (2012). *Leaders of the opposition: From Churchill to Cameron*. Houndmills, Basingstoke, Hampshire: Palgrave Macmillan; Crines, A. S. (2011). *Michael Foot and the Labour leadership*. Newcastle upon Tyne: Cambridge Scholars Publishing; Conroy, H. (2006). *Callaghan*. London: Haus Publishing.

help to end the Cold War and ultimately lead to the reunification of East and Western Europe.⁴⁰ Thatcher was committed to the continued promotion of trade between the UK and Eastern European countries; although the economies of Eastern Europe were struggling due to the second oil crisis in 1979, UK officials believed the region still offered valuable commercial opportunities for British companies.⁴¹

Where Callaghan had focused his attention primarily on increasing the number of high level ministerial visits in the hope of courting Eastern European leaders, Thatcher made an effort to extend visits across all levels of government in order to gain access to a greater section of Eastern European society – both governmental and business.⁴² To that end, the UK government founded the East/West Exchanges Department of the FCO, the Soviet Relations Committee of the British Council and the Great Britain/Eastern Europe Centre, alongside increasing funding for school exchanges which would serve to exhibit British culture in Eastern Europe.⁴³ As previously mentioned, these exchanges and visits were valued by Eastern leaders.⁴⁴

Thatcher's government put much more emphasis on the UK's role as a global power, wielding its foreign policy goals in the region in the open pursuit of Western influence and reunification of East and Western Europe. This led to the implementation of two key policies which were to

⁴⁰ TNA, FCO28/3702, *The East European Dimension paper* from Richard Parsons (UK ambassador to Hungary), 18 September 1979; TNA, FCO28/3683, *British Policy in East-West Relations*, despatch from Lord Peter Carrington (Foreign Secretary) to Sir Curtis Keeble (British Ambassador to Moscow), 7 December 1979.

⁴¹ TNA, FCO28/3683, *British Policy in East-West Relations*, despatch from Lord Peter Carrington (Foreign Secretary) to Sir Curtis Keeble (British Ambassador to Moscow), 7 December 1979.

⁴² TNA, FCO28/2440. *Note on the relations with politically sensitive countries*, from Norman Reddaway (Assistant Under-Secretary for Information and Cultural Affairs in the Foreign Office) to Howard F. T. Smith (Cabinet Office), 17 April 1974.

⁴³ Ibid.

⁴⁴ TNA, FCO28/4745, *Policy Towards Eastern Europe*, second paper circulated by Alan Montgomery (EESD) P.P. Nigel Broomfield (EESD) to Sir Iain Sutherland (UK Ambassador to Moscow), 6 August 1982.

define the UK's approach to Eastern Europe during the years leading up to the outbreak of the Eastern European sovereign debt crisis: the policies of differentiation and discrimination.

In line with the UK government's push to enact a stronger foreign policy towards Eastern Europe, UK government officials organized a small and informal Heads of Mission Conference, held on the 18—19th October 1979. It was intended to allow UK ambassadors stationed in Eastern Europe and the newly elected ministers of the respective governments to meet and informally discuss UK-Eastern European relations. Before the conference a number of papers were circulated for discussion. In one of them Richard Parsons (UK Ambassador to Hungary) urged the UK government to avoid making "generalizations about Eastern Europe...since each country has its own history and national aspirations." His paper and point of view made their mark at the conference, and subsequently on UK government ministers, and from this point on the importance of differentiating between Eastern European countries formed the basis upon which the UK government's differentiation and discrimination policies were pursued and can safely said to have characterized Britain's future involvement in the region.⁴⁵

Parsons believed it was in the interest of the UK and other Western governments to exploit this tendency in order to weaken the Soviet Union's control over the Eastern European region; driving a wedge between them and Moscow. He proposed to achieve this by encouraging nationalistic sentiment and identity in Eastern European countries as well as supporting influential individuals in arenas such as the arts, business and education.⁴⁶ The UK government hoped to exploit nationalism through the policy of differentiation; by treating each individual Eastern European country differently, they could play to the varying nationalistic tendencies in

⁴⁵ TNA, FCO28/3702, *The East European Dimension paper* from Richard Parsons (UK ambassador to Hungary), 18 September 1979.

⁴⁶ TNA, FCO28/3702, *The East European Dimension paper*, from Richard Parsons (UK ambassador to Hungary), 18 September 1979.

each country and therefore encourage their desire for greater autonomy from the Soviet Union.

On the 7th of December 1979, Lord Carrington (Foreign Secretary) writing to Sir Curtis Keeble (British Ambassador to Moscow) confirmed that the UK government had officially adopted a 'policy of differentiation.' Lord Carrington talked about how trade and East-West contacts and visits were being employed to weaken the grip of the Soviet Union by promoting the differences between the countries.⁴⁷ While the idea of differentiation was not entirely new – the diversity of Eastern European countries had been acknowledged by the UK Foreign and Commonwealth Office (FCO) as early as 1968 during the first Wilson government⁴⁸ – this was the first time the UK government became committed through official policy to differentiating between the Soviet Union and the countries of Eastern Europe, and between individual countries of Eastern Europe.⁴⁹ But when the Soviet Union invaded Afghanistan, causing a major rift in East-West relations, this new approach was put to the test. Nevertheless, the UK remained determined to continue with task of promoting the independence and diversity of the countries of Eastern Europe by maintaining contacts and exchanges. The UK Foreign Secretary, Lord Carrington, felt that Eastern European countries should not be associated with the actions of the Soviet Union. With this in mind, and in a direct application of the policy of differentiation, one of the UK government's first official responses to the invasion of Afghanistan was to issue a directive to all UK ambassadors stationed in Eastern European capitals, requesting them to demonstrate that the UK government acknowledged that Eastern European countries had not participated in the Soviet Union's invasion.⁵⁰

⁴⁷ TNA, FCO28/3683, *British Policy in East-West Relations*, despatch from Lord Peter Carrington (Foreign Secretary) to Sir Curtis Keeble (British Ambassador to Moscow), 7 December 1979.

⁴⁸ TNA, CAB148/37/19, Memorandum by the Secretary of State for Foreign Affairs on Relations with the Soviet Union and Eastern Europe, 17 June 1968.

⁴⁹ TNA, FCO28/5413, *Brief notes on Eastern European countries - UNWIN group on international financial issues*, from Kevin R. Tebbit (EESD) to Miss Copnell (ERD), 13 December 1983.

⁵⁰ Bucharest, Budapest, East Berlin, Prague, Sofia and Warsaw

4.1 – Thatcher’s policy of positive discrimination in Eastern Europe

As a result of the desire to strengthen the “policy distinction” between Eastern European countries, in 1980 the UK government took the process of differentiation a stage further by implementing a policy of positive discrimination towards Eastern Europe. This was intended to “identify and exploit the diversity of Eastern Europe” by rewarding those countries which displayed a measure of independence towards the Soviet Union, in line with the direction advocated by the UK ambassador to Hungary, Parsons a year earlier. This meant that some countries would gain favorable status which would lead to additional benefits: such as increased trade and easier access to loans or financial support from the UK government.⁵¹ Those Eastern European countries that displayed some degree of independence would be encouraged, to build a constructive and closer relationship with the UK.⁵²

In March 1981, the policies of differentiation and positive discrimination were to come under scrutiny when Jan Wołoszyn, the first Deputy President of the Polish bank Handlowy, met 40 bank representatives in London. His announcement that Poland’s economic conditions had worsened, and that the country was unable to maintain its payment responsibilities, triggered the Eastern European sovereign debt crisis. It quickly spread to Romania and to other countries in Eastern Europe.⁵³

The debt crisis made the UK government question whether retracting economic ties with Eastern European countries, however prudent, was in the wider national interest. Ultimately, the government decided to strengthen financial confidence in the region so that UK businesses and banks would continue investing and trading in Eastern Europe. Moreover, the UK was ready to support countries like Hungary because of the political importance of its economic policies.

⁵¹ TNA, FCO28/4745, *Policy Towards Eastern Europe*, second paper circulated by Alan Montgomery (EESD) P.P. Nigel Broomfield (EESD) to Sir Iain Sutherland (UK ambassador to Moscow), 6 August 1982.

⁵² Ibid.

⁵³ Zloch-Christy, I. (1987). *Debt problems of Eastern Europe*. New York: Cambridge University Press.

In a policy briefing on Eastern Europe it was recognized that the UK government “may no longer be able to look at commerce as the mainspring of our relations [with Eastern Europe] – but we should do our best to ensure that investments already made are not wasted.”⁵⁴ Even as the sovereign debt crisis gathered momentum a review of UK government policy towards Eastern Europe decided it was business as usual: Britain would continue treating Eastern European countries “based on the principles of positive discrimination” in which UK policies would be adjusted on a case-by-case approach, depending on the circumstances.⁵⁵

The UK government continued to promote ECGD credits to Eastern European countries even when they became aware that these countries’ economies were struggling. Evidence of this is provided by the archives of an Export Guarantee Committee (EGC) meeting held at the HM Treasury in March of 1980. The FCO urged the ECGD to “not overlook the positive signs” – in reference to the improved situations in Hungary, Czechoslovakia and Poland – despite acknowledging the “considerable economic difficulties” Eastern European countries were facing.⁵⁶

Furthermore, the FCO exerted direct political influence over the ECGD in pursuit of the UK government’s positive discrimination policy. In one example, it openly challenges the ECGD’s decision to downgrade cover for UK exports to Hungary from category B to category C, along with those to the GDR and Czechoslovakia. Such an action was not economically justifiable, asserted Malcolm Rifkind (Parliamentary Undersecretary of State for FCO), noting that Hungary’s exposure of £51m was the second lowest of any Eastern European country in the

⁵⁴ TNA, FCO28/4745, *Policy Towards Eastern Europe*, second paper circulated by Alan Montgomery (EESD) P.P. Nigel Broomfield (EESD) to Sir Iain Sutherland (UK ambassador to Moscow), 6 August 1982.

⁵⁵ TNA, FCO28/4745, Summary of Points agreed at the Secretary of State’s meeting on relations with the Soviet Union and Eastern Europe, 15 September 1982.

⁵⁶ BoE, 6A175/1, Minutes of a meeting of the Export Guarantee Committee on Friday 14 March 1980 at 3pm by HM Treasury 24 March 1980.

ECGD portfolio.⁵⁷ Following government advice and pressure from the FCO, the ECGD reversed its decision to downgrade Hungary. The FCO had argued that doing so would undermine confidence in Hungary at a critical time when Eastern European countries were struggling economically. The ECGD also agreed that it would not downgrade Hungary in future without “further consultation with the FCO and other Whitehall Departments.”⁵⁸ These exchanges highlight the political nature of such decisions and the way in which the UK government used the ECGD as a tool to support the UK’s continued economic involvement in Eastern Europe. By preventing Hungary from being downgraded, UK businesses would have continued expanding trade and banks would have continued investing money in the country as a result of its good credit rating. This occurred, as previously discussed, even though the UK government had been aware of the increasing levels of debt in Eastern Europe as early as 1977.

5 – Conclusion

From the mid-1970s and the start of the 1980s, the UK government’s relationship with Eastern Europe became increasingly politicized. The UK government’s diplomatic and financial relations with Eastern Europe improved steadily under the Labour Wilson/Callaghan governments, which laid the foundation for the more assertive foreign policy of Thatcher’s Conservative government and its approach to Eastern Europe in the run up to the 1981 sovereign debt crisis. This politicization played a significant role in creating the environment for the development of the Eastern European debt crisis.

The archival evidence presented in this paper demonstrates how the UK government bears a greater responsibility for the development of the debt crisis in Eastern Europe, than has been attributed to it in the sovereign debt literature hitherto, due to its foreign policy goal of encouraging Eastern European countries to move away from the Soviet Union and, to a lesser extent, to assist the struggling UK domestic economy. These goals influenced UK policies

⁵⁷ Ibid.

⁵⁸ Ibid.

towards Eastern Europe and contributed to Eastern European countries' debt build-up in the form of sovereign loans.

With the two exceptions noted at the beginning of this paper, the current literature on the sovereign debt crisis does not discuss or analyze the impact that politics had on the development of the crisis, thereby disregarding the political climate in which the crisis took place. This paper challenges this approach by demonstrating that the UK government's continued encouragement of UK banks and businesses to trade and lend to Eastern Europe was driven by its desire to pursue its political goals and that it therefore bears a significant responsibility for the development of the Eastern European sovereign debt crisis.

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