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PREM 19/928

PART 2 ends:-

OCTOBER 1982.

PART 3 begins:-

NOVEMBER 1982.


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Trade

Tg 01478

PRIME MINISTER

Trade Policy

(E(82)71, 72 and 73; Foreign and Commonwealth Secretary's minute PM/82/86)

Attendance

1. In addition to E Committee members, the Lord Chancellor and the Attorney-General have been invited. Lord Trenchard will be deputising for the Defence Secretary.

BACKGROUND

2. Protectionist trade policies which impede UK exports have been of concern to Ministers for some time. The Committee has discussed them previously in 1980 (E(80)21st Meeting), which identified some specific measures of benefit to UK industry, and more recently on 25 February 1982 (E(82) 6th Meeting) when the Committee considered memoranda from the Trade Secretary (E(82)^{FLAG A}10) and the CPRS (E(82)^{FLAG B}15). The Committee agreed that it was in general right to pursue an open trading policy and to avoid systematic covert protection of British industry and the erection of non-tariff barriers, and approved action to persuade the European Commission to act more vigorously against illegal and unfair trading practices in intra-Community trade. The particular problem of Japan was discussed by Ministers at OD(82) 9th Meeting on 27 May, when it was agreed that the United Kingdom should continue to press its views in the European Community (EC) on the need for a change in Japanese trading practices and economic policies, placing particular emphasis on the restrictive aspects of

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Japanese financial policy, the international role of the yen and access to the Japanese capital market.

3. In E(82)71 the Secretary of State for Trade draws attention to the high tariffs and quantitative restrictions which often face UK exports outside the Community and EFTA, in contrast to the low tariffs and few quantitative restrictions on non-agricultural imports into the EC. He invites the Committee to consider what action the UK could take to strengthen its position in relation to protectionist trade policies by other countries, particularly Spain, Australia, Japan, USA and the newly industrialised countries (NICs). He points to the resentment of British firms at the apparent inaction of the UK, and lists a number of options for action which could be further explored for use after the GATT Ministerial if, as seems likely, that meeting fails to deal effectively with discriminatory practices. In E(82)73 the Foreign and Commonwealth Secretary points out some of the constraints which have to be taken into account. He concludes that unilateral action will seldom be profitable or sustainable, and that the process of persuasion and negotiation will generally continue to serve UK interests best. The Foreign and Commonwealth Secretary has also circulated with his minute PM/82/86 two papers agreed interdepartmentally at official level on action which might be taken within the Community to deal with the Spanish problem. The CPRS have also put in a Note with proposals both on the general approach which should be adopted and for a fuller study of possible action on car imports from Spain.

4. The problem of discriminatory practices remains acute because of the continuing pressure from British industry, especially on cars. This is likely to be increased by the measures just announced by the French government for inhibiting imports by obligatory country of origin marking and requiring all import documents to be in French.

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MAIN ISSUES

5. The papers before the Committee discuss more than a dozen options, and it will hardly be practical to go into each one in detail. Nor is the Secretary of State for Trade inviting the Committee to do so; he is asking only that officials should be instructed to examine them in further depth so that the Government will be ready to act without delay. It would therefore probably be most useful for the Committee to discuss the following questions:

- i. whether the general approach of taking action against imports from countries which deny comparable access to our exports would be likely to persuade these countries to open up their markets to the UK; and if so whether it should be taken
 - a. through the Community and/or
 - b. unilaterally;
- ii. whether any of the options should be ruled out now;
- iii. whether any action can be taken in advance of the official study.

An assessment of the individual proposals is annexed.

The General Approach

6. The Committee will no doubt wish to endorse the general aim of promoting UK exports and to give emphasis, as the Foreign and Commonwealth Secretary and the Secretary of State for Trade both do, to taking action whenever possible through the Community and GATT machinery. But, as the CPRS point out, this can be slow, and Ministers will want to consider the scope for unilateral action to defend the interests of British industry. In doing so, the constraints to which the Foreign and Commonwealth Secretary draws attention in E(82)73 will need to be taken into account. The CPRS also put forward a number of criteria which should be used in judging the desirability of unilateral action in individual cases. In particular, the Committee will want to consider:

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- a. Possibility of a Protectionist Spiral The strains on the open trading system could be significantly increased if a major trading nation such as the United Kingdom were to be seen to adopt protectionist policies. The fact that the USA is taking an increasingly protectionist posture and that the French have just announced protectionist measures could mean that any UK action now would risk provoking a snowball effect. Any degeneration into general protectionism is bound to affect the UK particularly seriously with our very considerable dependence on foreign trade.
- b. Possibility of Trade Retaliation The NICs in particular have shewn themselves ready to use trade retaliation, especially against the United Kingdom (eg Indonesia in 1980 because of our tough line on textiles, and Malaysia in 1982 for mainly political reasons), and Australia has also threatened retaliation (in 1980 and 1981 over Community beef import quotas). If the main objective of our actions is intended to be to get other countries to open up their home markets, the risk of retaliation in any particular case would be, as all the papers before the Committee recognise, particularly relevant.
- c. Possibility of Action in the United Kingdom Courts by aggrieved importers if measures are taken which are contrary to current rules. It would be embarrassing to the Government to be overruled, and the UK legal system does not afford the scope for administrative delay and evasion possible in some other member states of the Community.
- d. Possibility of Problems with the Community These could include action in the European Court against United Kingdom measures not in accordance with Community law. The Commission are already urgently investigating the new French measures, several of which are likely to be illegal in Community terms (eg the tax concessions on exports, which are similar to the US DISC scheme which the

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Community has attacked in GATT; the translation of customs documents; and bilateral negotiations with third countries on trade matters within Community competence), and it seems likely that the French may have to climb down at least partially. It is true that action in the Community could in many cases be counted on to take place in slow time, and therefore give the UK a year or so of freedom of manoeuvre. But a case in the European Court against domestically popular measures would be unfortunate in terms of public opinion towards the Community. Any too obviously anti-communautaire action could also be damaging to our relations with the Community as a whole.

- e. The GATT Angle The Trade Secretary's paper E(82)71 points out the need to take the GATT Ministerial Meeting into account in deciding the timing of any measures. The Committee will also want to bear in mind that GATT rules forbid certain practices and allow countries against whom action is taken in certain circumstances to demand compensation or to take retaliatory measures. A GATT spokesman has already been publicly quoted as warning against measures to block imports.

The Proposals

7. The memoranda by the Secretary of State for Trade and the CPRS (E(82)71 and 72) set out a number of specific options for action after further study by officials. These are a possible Community initiative for greater trade reciprocity (paragraph 7 of E(82)71); emergency unilateral action under Community rules against import surges (paragraph 7 of E(82)71); Community action against imports from Spain (paragraphs 8 of E(82)71, 5 of E(82)72, and PM/82/86); unilateral safeguard action against Spain; a possible quota on Australian exports to the UK of Mitsubishi ~~---~~ (paragraph 9 of E(82)71); selective action under the 1962 Anglo-Japanese Trade Treaty (paragraph 10 of E(82)71); the scope for action against the USA (paragraph 11 of E(82)71); a Trade Reciprocity Act to remove the obstacle to unilateral action in the 1972 European Communities Act (paragraph 12 of E(82)71); and a possible Imports Advisory Board

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(paragraph 13 of E(82)71). The Committee is unlikely to wish to discuss each of these in detail, but they are individually assessed in the Annex to this brief in case any specific issues are raised. Unless the Committee wishes to exclude any particular option from further examination, it may wish to endorse the Secretary of State's proposal that they should be studied further by officials. If the Committee endorses the Secretary of State's conclusion that the United States is a special case, this option could be excluded from further study. The Committee may also wish to consider whether the very difficult issues raised by the idea of a Trade Reciprocity Act are unlikely to make detailed examination of this option a worthwhile exercise.

Timing

8. The Secretary of State for Trade proposes (paragraphs 14 and 15 of E(82)71) that the Government should avoid dramatic action before the GATT Ministerial, to avoid attracting the blame for any failure. As the Government's main interest in the GATT Ministerial is as an encouragement to the maintenance of the open trading system, it would indeed look odd for the UK to take a major protectionist initiative immediately before the meeting. In any case, a number of the proposals put forward require further study to establish their feasibility. But, as the Government's intention to do something about discriminatory trade practices is already well known, there could be a sense of anti-climax if no action were taken before the GATT Ministerial. Action which could be initiated now includes the initiative in the Community on the general question of unfair discriminatory practices (paragraphs 2-3 of the Annex), which could serve as a softening up for subsequent concrete proposals, and the two proposals for action on Spain in the Foreign Secretary's minute PM/82/86 (paragraph 10 of the Annex).

9. The Committee may also wish to endorse the Trade Secretary's proposals that the UK should also express its concern at the GATT Ministerial, and meanwhile trail this line in speeches, as he has already begun to do (eg in the House of Lords on 20 October). In this context, the Committee will wish to consider the line to take in the Debate on the Address.

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HANDLING

10. After the Secretary of State for Trade has introduced his memorandum, you will wish the Foreign and Commonwealth Secretary and Mr Sparrow to speak to their papers. The Committee will also wish to hear the comments of the Industry Secretary and the Chancellor of the Exchequer.

11. After discussion of the general issues, you may wish to seek comments on whether any of the proposals should not be the subject of detailed study (the Lord Chancellor and the Attorney-General in particular may have comments on the legal aspects of what is proposed). The Committee could then consider the timing and presentational aspects.

CONCLUSIONS

12. You will wish the Committee to reach conclusions on the following:

- i. whether new initiatives are required to remedy the grievances of UK industry in the face of protectionist policies by non-Community countries against our exports;
- ii. whether the proposed study by officials of possible initiatives should be extended beyond the Community and GATT machinery to embrace the scope for unilateral action;
- iii. whether any of the specific proposals for new initiatives, such as the scope for action against the United States and a Trade Reciprocity Act, should be ruled out now;
- iv. whether any of the proposals, such as beginning work in Brussels on the Community initiative for greater trade reciprocity and on the two proposals on Spain in the Foreign Secretary's minute, could be acted on before the GATT Ministerial meeting;



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- v. whether Ministers should express their concern at the lack of trade reciprocity in speeches leading up to the GATT Ministerial and at the meeting itself.

GUY STAPLETON

27 October 1982

CONQUEROR

SPECIFIC PROPOSALS

A Community Initiative for Greater Trade Reciprocity

1. The Trade Secretary suggests (paragraph 7 of E(82)71) that this should both urge a tougher approach to the NICs and support recent French proposals for closer surveillance of sensitive sectors and for a trade complaints mechanism.

2. A tougher approach to the NICs is already being discussed by the Preparatory Committee for the GATT Ministerial Meeting. The Americans and Swiss, whose GSP schemes run out in 1985, have told the NICs that their legislatures are unlikely to agree to renew these unless the NICs make concessions by lowering their tariff barriers. The NICs have refused to consider any such deal (in any case few are members of GATT, and two of the most important - Hong Kong and Singapore - have no tariff barriers). The Community has therefore approached the question more cautiously in the GATT, suggesting a feasibility study on possible negotiations in which the NICs would be offered a contractual GSP scheme (instead of the current autonomous Community regime) in exchange for lowering their tariffs. The Trade Secretary has suggested to the Foreign and Commonwealth Secretary that the UK should continue to argue, with the USA, that the NICs should progressively apply GATT rules and that, if we have to settle for a feasibility study, we should argue for this to be completed quickly. Other action the Community could take would be simply to withdraw GSP treatment from the NICs in its current annual review of its own GSP. But this could bring the risk of trade retaliation either against the Community as a whole, or against the United Kingdom if we were known to be the moving spirit behind any such proposal (and our partners would not hesitate to put the blame on us). There may therefore be UK interest in avoiding action against the NICs which appears too confrontational, or in becoming isolated in appearing to take the lead.

3. The French Memorandum, which proposes closer import surveillance and provisions for a complaints procedure and executive action against unfair trade practices similar to Article 301 of the United States Trade Act, is being discussed within the Community. The UK has hitherto taken a sympathetic but questioning line. The Commission has put forward informal counter-proposals involving surveillance but no complaints procedure.

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In practice the United States' complaints procedure has not proved very useful. But for the Community to set up such a mechanism would be a signal of the seriousness with which it takes the problem of unfair practices. The Committee should therefore be able to agree that we should support the French proposals, subject to satisfaction on such details as the decision-making procedure.

Emergency Unilateral Action against Import Surges

4. The Trade Secretary also suggests (paragraph 7) that the UK should in addition be prepared to take emergency unilateral measures under Community rules against import surges, though he notes that without Community support such measures could last only 1-3 months. The Committee may decide that it would be sensible for officials to examine the possibilities but that in considering individual cases the United Kingdom would have to take into account the likelihood of Community support and the impression which might be made on domestic opinion if the UK had to cease its measures after only a short time because of Community opposition, when to continue them could lead to the risk of action both in the UK courts and the European Court.

Community Action against Spain

5. The Trade Secretary proposes Community action against Spain (paragraph 8), and the CPRS Note also makes suggestions for dealing with the Spanish problem. The specific proposals are:

- (i) Place type approval difficulties in the way of imports of the new General Motors (GM) Corsa car;
- (ii) Require country of origin markings on vehicles;
- (iii) Persuade the multi-national car firms to take action themselves to improve the balance of trade in vehicles and components;
- (iv) Use the safeguard provisions of the EC/Spain Trade Agreement of 1970.



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6. In considering use of type approval to block the Corsa, the likely reaction of General Motors and in particular the effect on its attitude to investment in the UK will need to be taken into account. Action which hit other vehicles as well as the Corsa could provoke an adverse reaction from Ford. Both companies work on the basis that an integrated European operation is necessary for viability, and successive UK administrations have accepted this. Depending on the precise measures taken, there could also be legal problems: this is an aspect which officials would need to examine further before any final decision were taken.
7. A requirement for a country of origin marking on vehicles, proposed in paragraph 5(iv) of E(82)72, is a possibility which has already been mooted in public debate, and would correspond to one of the recently announced French measures. But its effectiveness in reducing imports seems doubtful, especially given eg the recent report that Spanish-made Fiestas may be more reliable.
8. An approach to the car companies to improve the balance of trade is proposed in paragraph 5(ii) and (iii) of E(82)72. Such an approach would do no harm, but there seems no reason to suppose that Ford or General Motors would in practice be prepared to respond favourably. BL interest in increasing assembly in Spain (ie to overcome the high Spanish tariff barrier) may also not be great given the normal Spanish insistence on at least 65 per cent local content.
9. The possibility of retaliation by Spain would also need to be taken into account: Lord Trenchard (representing the Defence Secretary) will probably want to warn about the risk to defence contracts. The Foreign Secretary may also be concerned about possible implications on Gibraltar.
10. Investigating the possible use of safeguard action under the 1970 EC/Spain Agreement by the Community is proposed in the Foreign Secretary's minute PM/82/86. This reflects an interdepartmentally agreed recommendation and the Committee may therefore wish to endorse it, although the Foreign Secretary may note the need to avoid appearing to be acting against the new Spanish government immediately after it takes office. The Committee

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may also be able to agree without difficulty to the other proposal circulated by the Foreign Secretary - action within the Community to get better transitional arrangements after Spain's accession.


11. As for the possibility of unilateral safeguard action against Spain, there may be legal problems given that there are no current provisions in the EC/Spain agreement allowing unilateral action, and the UK would have to rely on the normal import regulation 288/82 which may not be compatible (this allows for a 1-3 month grace period - see paragraph 4 above). If this possibility were pursued, therefore, the Committee may wish to endorse the CPRS recommendation (paragraph 5(i)) on efforts to persuade our EC partners to acquiesce in unilateral action, especially if the Community itself were unwilling to take action.

Possible Quota on Australian Exports of Mitsubishi cars

12. The Trade Secretary proposes (paragraph 9) that we should make clear to the Australians that we shall take emergency action if Australian exports of Mitsubishi cars reach significant proportions. Whether the UK would obtain the necessary Community support for such action is however questionable, as the Australians will know. The Australians may attempt to call what they will see as a UK bluff, threatening retaliation if the UK carries out its threats. Their sense of grievance over Community policy is strong, and they are very conscious of their huge deficit in trade with the UK. Under GATT rules they could in any case demand compensation if the UK were for example to impose higher tariffs.

Selective Action under 1962 Anglo-Japanese Trade Treaty

13. The Trade Secretary discusses (paragraph 10) the use of selective action under the 1962 Anglo-Japanese Trade Treaty. This possibility has previously been considered by Ministers when they have noted that it would be subject to Community approval under the UK's EC Treaty obligations, and to Japan's right under GATT rules to retaliate in equal measure against our imports. While experience has shown that Japan only responds to strong and persistent action, the Committee will wish to bear in mind the potential risks to the inter-industry restraint arrangements on which we have hitherto relied, and which we are still trying to negotiate,



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for example, on machine tools. The Committee may wish officials also to consider, as suggested in the CPRS Note (paragraph 3(ii)), the pursuit of informal arrangements, together with continued strong pressure on Japan through the Community and in other international economic fora.

The United States

14. The Trade Secretary points out the difficulties of any action against the United States (paragraph 11). The settlement of the steel dispute also removes one of the major irritants in EC/European relations. The Committee may agree that this does not merit further study.

A Trade Reciprocity Act

15. An Act to remove the obstacle to unilateral action in the European Communities Act is proposed in paragraph 12 of E(82)71. The Secretary of State for Trade notes, however, that such a move would be challenged as incompatible with the EC Treaty. You will also have in mind the possibility of the UK having to take legislative action of a not dissimilar character to set aside part of the European Communities Act in order to permit withholding of part of the UK contribution to the Community Budget. This proposal could therefore have major repercussions on the UK's whole relationship with the Community.

Imports Advisory Board

16. This proposal (paragraph 13 of E(82)71) is likely to prove less controversial. Such a Board would enable cases to be thoroughly and openly examined and would diminish the influence of purely political pressure for protection. On the other hand, the ability to take effective action would be no greater, finance would have to be found, and the Board could be attacked as just another quango. The Committee may however decide that the proposal merits further study by officials.

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Prime Minister ⁽²⁾ 26 October 1982

ALAN WALTERS

MUS 26/12

PRIME MINISTER

TRADE POLICY: SECRETARY OF STATE'S MEMORANDUM OF 21 OCTOBER

I am not clear what the Secretary of State intends to be the substantive conclusion of the E discussion. But I agree with some of the conclusions of the Secretary of State's memorandum. In particular the GATT Ministerial meeting is unlikely to make any substantial progress towards further trade liberalisation, and if it manages to arrest the drift towards world protectionism, that is probably rather more than we can expect. This is a pessimistic conclusion, but I do not think any other is warranted.

Objectives of Policy

The objective of our free trade policy should be to get foreigners to reduce their trade barriers. The alternative tactics to achieve this objective are:-

- (a) Reduce our trade barriers (the bilateral or multilateral trade disarmament of GATT, Kennedy and Tokyo rounds).
- (b) Increase our trade barriers ("retaliation" of the 1930s vintage).
- (c) Use other means of persuasion (eg Aid negotiations).

Methods and their Relative Efficiency

The best method is (a) - barrier reductions. The Secretary of State does not mention this because he may argue that we have got to nearly the end of feasible reductions. But this is clearly not the case. Apart from the obvious examples of Japanese cars (a "voluntary" arrangement), there are many less obvious examples, such as the absolute ban of CEGB's import of coal from USA or South Africa. (This latter arrangement enhances the power of the NUM, keeps coal prices high and raises all derivative prices such as steel, motor cars, etc). There are many such barriers, the reduction of which would serve our interests. Since we are a small part of world trade, unilateral reduction is normally our best policy.

/The worst method

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The worst method is (b) - increasing the barriers - yet this is the one seemingly favoured by the Secretary of State. All the evidence of history shows that "retaliation" has led to higher, not lower, tariff barriers. [Carried out à l'outrance between two large trading blocs, W.M. Gorman showed it would lead to around a 70% reduction of trade!] Retaliation would create protected industries and trade unions (such as the NUM) with their political lobbies and captive politicians. This policy is inconsistent with all that you stand for. However, if you do decide that retaliation is the right course, then it is best to ensure that it is very limited indeed and restricted in time (a sunset clause).

A good method - (c) - may be to use other means of persuasion. Consider for example India. Aid presents us with a considerable weapon which we can deploy to open up a market. India receives 40% of IDA funds. As a condition of our contribution to IDA, we might well propose that India substantially reduce her quota restrictions. Alternatively, we may suggest to India that our bilateral aid programme will be adjusted according to progress they make in eliminating their import quotas. In the case of South Africa we may offer to reduce the present restrictions on the import of coal for our power stations. (This, incidentally, would reduce the National Union of Mineworkers' stranglehold on electricity generation and, albeit after the next strike, would be good in its own right.)

*Don't want
unh. Aid
not big
enough.*

Some NIC's are being increasingly encouraged to follow the successful path of Chile in reducing all tariffs in 1975-76 to a uniform 10%. We need to encourage this process and we ought to evolve a policy for doing so.

With Taiwan and Korea there are many difficult problems associated with their security. We have little leverage. The main influence must be the policy of the United States. One could encourage the United States' Government to think in terms of using its capacity to supply military aid and hardware for the purpose of trade liberalisation.

Another possibility is, of course, using official credit policy to induce tariff reductions. This would probably require some OECD initiative.

Export Subsidies

The Secretary of State's memorandum deals almost entirely with import restrictions imposed by foreigners. Yet there is the vexed question of alleged export subsidies, such as in the case of French turkeys, United States textiles, and above all steel. In principle these are much less objectionable than import quotas and tariffs. The subsidy is usually explicit, it has to be financed, and is obviously harmful to the exporting country. Furthermore, if, for example, the United States subsidised energy well below world market price and thus exported energy-intensive goods below market cost, then in the long run this must benefit us. In the short run there will be adjustment costs and many political reasons to prevent such short-run disruption, to which we must respond. But, in the long run, if they are giving us something for nothing, why not take it?

Imports Advisory Board

The Secretary of State's suggestion for an Imports Advisory Board is potentially a valuable one. It is of the utmost importance, however, to ensure that it really is independent, has technical expertise, and is composed of people who fundamentally believe in freedom of trade. They must be quite independent of industry pressure.

Technical knowledge is extremely important in this field. The list of tariffs in the Annex to the Secretary of State's paper is misleading. First, they are nominal not effective rates of protection. Secondly, there are often parallel excise duties which tend to nullify the tariff. It is, in fact, quite difficult to determine precisely the degree of protection. So we need to be quite clear what we are talking about before we get involved in the detailed decisions.

Unemployment and Trade Barriers

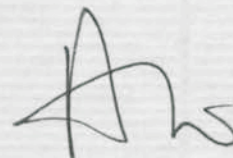
The Secretary of State's memorandum does not mention the main rationalisation for retaliatory measures. This is because it is thought that it will preserve jobs. In the unlikely absence of further retaliation by the foreigner, and in the very short run, this may well be true. But, like the effect of an inflationary expansion of demand, positive effects in protecting employment will

soon be gone and there will be every reason to believe the long-run effect will be negative. Unemployment is caused primarily by wages being above their market clearing levels. A protective tariff will discourage any moderation of wages (as one can see in, for example, the behaviour of the mineworkers over these last five or six years). In the protected field, and probably also in the unprotected areas, prices will be higher. This is unlikely to encourage wage moderation for workers in the non-protected industries. Essentially they will be paying a tax to support the high wages of the workers in the protected industries. We also must add to these effects the well-known loss of efficiency that is always associated with increases in protection. In sum, therefore, retaliatory tariffs are considerably worse than general monetary expansion as a means of promoting a temporary surge in employment; the tariff is focused and discriminatory, and is likely to give rise to further retaliation. And in the long run it will reduce employment by keeping wages up and slowing down the adjustment process.

Conclusion

I suggest that it would be best if E Committee agreed that the basic strategic objective was to reduce the trade barriers of our trading partners and not to protect against imports. All the measures suggested by the Secretary of State should be judged solely in terms of this criterion. I hope E will take a rather jaundiced view of the efficiency of "retaliatory" measures; the evidence certainly points to such a conclusion.

Secondly, I suggest that we use a wider set of instruments in a more imaginative way in order to achieve the objective. For example in seeking reductions in the Spanish tariff we might offer our enthusiastic support for Spain's entry into EEC. We need to play all our hand and not merely the trade cards.



ALAN WALTERS

26 October 1982



From the Secretary of State

Willie Rickett Esq
Private Secretary to the Prime Minister
10 Downing Street
London
SW1

25 October 1982

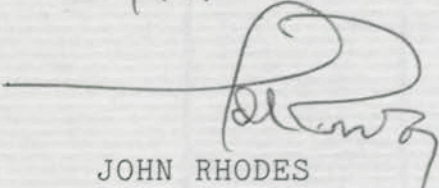
Dear Willie

IMPORT CONTROLS: DEFENSIVE BRIEFING

You spoke to John Whitlock here at the end of last week, requesting briefing for the Prime Minister on the disadvantages of import controls. I attach briefing accordingly.

I should draw your attention to the last point, number 11. This is obviously a rather different point from the 10 previous ones, but is arguably the most important point to convey.

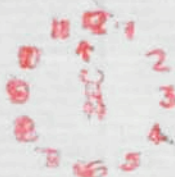
Yours sincerely,


JOHN RHODES
Private Secretary



UNITED KINGDOM OF GREAT BRITAIN

25 OCT 1982



COMMERCIAL

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N. B. P. R.

FCS/82/168

AN 28/10

SECRETARY OF STATE FOR TRADE

PREPARATIONS FOR THE GATT MINISTERIAL MEETING:

DISCUSSION AT THE FOREIGN AFFAIRS COUNCIL - 25/26 OCTOBER

Thank you for your letter of 21^{altered} October. I think the general thrust of the line you propose Peter Rees should take at the Foreign Affairs Council is admirable. It is reasonable without being unrealistic and emphasises our proper concerns. I particularly welcome what you say on developing countries. The Community, and in particular the UK, already has a respectable record on market access for the LDCs, but it is right that we should look for ways of doing whatever else we can for the poorest. At the same time we must urge on the Community the importance of an effective approach to the problem posed by the unfair and unnecessary barriers to our exports maintained by increasingly prosperous NICs. Hong Kong and Singapore have already demonstrated that industrial development is not dependent on a highly protected market. Others must be brought to appreciate the merits of following their example.

I appreciate that in outlining our position in your letter you have kept to the bare essentials. In putting our views to the Council I hope it will be possible for Peter Rees to take account of the following additional comments.

/ (a)

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- (a) Although safeguards are, as we have agreed in earlier correspondence, an over-worked subject, they remain highly sensitive politically. I think therefore that we should continue to express willingness to explore any ideas which are, on balance, potentially helpful to our concerns and which could have important presentational advantage. Depending on the exact nature of the proposals, something on transparency could come into this category.
- (b) On dispute settlement we need to work for a position which can command consensus in the EC, while still offering the prospect of some increased leverage on the US. We agree that the status quo is unsatisfactory in this respect. We should therefore look for a formula which offers the minimum reassurance necessary for Member States concerned about the implications for the CAP, while enabling them to drop the total opposition they have expressed to any meaningful reform of the GATT machinery.

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I understand that our officials have agreed briefing for the Foreign Affairs Council should be prepared on this basis.

Copies of this minute go to the Prime Minister, to other members of OD(E) and to Sir Robert Armstrong

A handwritten signature in dark ink, appearing to be 'FP', with a small dot below the 'P'.

(FRANCIS PYM)

Foreign and Commonwealth Office

25 October 1982

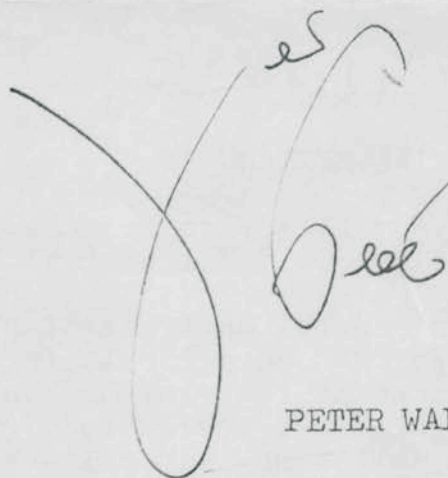
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25 OCT 1982

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My Department fully accepts the need for a thoroughgoing reform of the CAP but, as you point out, to achieve this we must adopt a sufficiently compromising line to carry our Community partners with us. In this context I do not entirely understand your reference to "doing nothing to impede the maximum pressure being brought on the CAP at the GATT Ministerial". We would certainly lose credibility with our partners if we even passively encouraged some of the more exaggerated US and Australian criticism of the CAP.

I am copying this letter to the Prime Minister, Francis Pym and other members of OD(E) and to Sir Robert Armstrong.

A large, stylized handwritten signature in black ink, consisting of several loops and a long horizontal stroke.

PETER WALKER

P.S. There are only 2 countries
with a more protectionist
position than the CAP. —
USA and Australia !!



cc PS/MfT
PS/Secretary
Mr Gray, Dep Sec
Mr Sunderland, OT 2
Mr R Williams, ITP
Mr Meadway, ITP 1
Mr Stone, ITP 1
Miss Brimelow, ITP 1

From the Secretary of State

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The Rt Hon Francis Pym MC MP
Secretary of State for
Foreign and Commonwealth Affairs
Foreign and Commonwealth Office
Downing Street
London
SW1A 2AL

21 October 1982

Francis

THE GATT MINISTERIAL MEETING

We expect a substantial discussion on the GATT Ministerial Meeting at the Foreign Affairs Council in Luxembourg on 25/26 October which Peter Rees will be attending.

Our discussions on trade policy in the E Committee take place during the Luxembourg meeting, but colleagues will want to know what line we shall be taking on the main issues.

It is difficult even now to be certain what the precise issues in Luxembourg will prove to be. The Commission is this week engaged in almost continuous formal and informal discussion in Geneva on the basis of general orientations agreed by the July FAC. (The United Kingdom line for that meeting was settled in correspondence finishing with my letter to you of 19 July.)

I attach a short note by my officials summarising the main developments inside and outside the EC since the summer break, and focus on those points that may cause the most difficulty in the final run-up to the GATT Ministerial meeting.

In summary our line on these issues is as follows:-

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From the Secretary of State

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- (a) We cannot agree to an explicit ceasefire on new protective measures because we may wish to introduce some such measures (including against countries, such as Australia, which maintain heavy restrictions against our exports). We could agree, for what it is worth, to some new broad trade pledge on efforts to resist protectionist pressures.
- (b) We cannot abandon our claim that Article XIX permits safeguard measures to be taken on a selective basis, ie against import surges from particular countries. Unless we have this possibility the basis for seeking restraints, by so-called grey area measures, will be much reduced. And we shall continue to argue that, far from undermining the GATT, restraint arrangements avoid the worse tensions that formal measures would create.
- (c) On agriculture, we shall do nothing to impede the maximum pressure being brought on the CAP at the GATT Ministerial. But, unless the Germans and others do so, we shall not openly urge a more forthcoming Community line on agriculture because this would impede rather than further our aim of internal reform of the CAP.
- (d) On the developing countries, we shall be ready to scrape the barrel for further concessions (on tropical products not textiles) for poor countries. But we shall continue to argue, with the Americans, that the newly industrialising countries (NICs) must progressively apply GATT rules. The idea that NICs

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From the Secretary of State

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should phase themselves in through new negotiations is naturally vigorously opposed by the whole Group 77. The truth is that the days of largesse for the developing world, while they take no obligations in return, are over. In the end we may have to settle for a feasibility study, but we should take the line that this should be completed quickly.

- (e) We shall support improvement in dispute settlement procedures - more conciliation and decisions to be taken by consensus in which the parties in dispute would normally not participate. This could be helpful to us on American sins - and also on Community sins which are mostly in the agricultural area. But we must support the view that, in the last resort, a Contracting Party should have a veto where GATT action against it is involved.
- (f) We must support a GATT study of service industries where the Americans are more enthusiastic than our Community partners. And the G 77 flatly against the idea.

I must add three points:-

- (i) It is obvious that the whole climate may be further affected by developments in EC/United States disputes - including on steel and the Pipeline.

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From the Secretary of State

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(ii) The Foreign Affairs Council will also be considering how to maintain pressure on Japan (the next steps in the Article XXIII procedures). At the same time, as I said in my letter of 19 July, we must urge that the Political Declaration of the GATT Ministerial Meeting should make some referenceto problems raised by Japan.

(iii) The G 77 are said to be becoming less enthusiastic about a GATT Ministerial which they earlier saw as an opportunity to bring pressure on the developed world (including on MFA textiles which is also on the FAC agenda). They do not like the firm stands being made on safeguards, the demands that the NICs should apply the GATT, or the proposal to extend the GATT into services. We must do our best to get a balanced settlement because a failed GATT Ministerial could have repercussions on the whole world trade and payments structure. But we cannot go for a success based on giving up our legitimate requirements.

That is the position as I see it. I hope that during the first fortnight in November the key questions will become sufficiently clear for me to be able to put to colleagues proposals on how we may best use the opportunities provided by the Ministerial Meeting to progress in the right direction on some of our current concerns.

One last point, there is some informal talk about a further GATT Ministerial perhaps in 1985. I do not think we should oppose this, especially if the prospect of another such meeting averted the feeling of breakdown in GATT.

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From the Secretary of State

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I am sending copies of this letter to the Prime Minister, to the Members of OD(E) and to Sir Robert Armstrong.

*Yours,
Arthur*

LORD COCKFIELD

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GATT MINISTERIAL MEETING 1982: DEVELOPMENTS SINCE JULY

Note by the Department of Trade

At the end of July the Chairman of the Preparatory Committee issued a document which brought together all the proposals that had been tabled. On most issues it incorporated the maximal hopes of protagonists. At this stage there was little consensus about what the meeting might achieve and the negotiation necessary to reduce the maximal demands to what there could be consensus on had scarcely begun. This started in the latter half of September and has been fully engaged ever since. Developments on the main topics are briefly summarised below.

POLITICAL DECLARATION

This is seen as a text in which Ministers re-affirm their commitment to the world open trading system, and its strengthening in very difficult times. Its drafting is however interlinked with the specific commitments on particular points Ministers might be prepared to undertake. Following a detailed and premature initiative in May by Mr Fraser, the Australian Prime Minister, a more general idea of a ceasefire or standstill on measures increasing the tendency to more protection or to an unravelling of the whole open trade system, gained ground in September. However the first text (dated 27 September) incorporating these ideas into a political declaration proved over-ambitious in the extent of the changes envisaged regarding policy in sensitive areas such as textiles, agriculture and safeguard and grey area measures: some of the drafting raised major problems for the United Kingdom. The Community decided in early October to throw its weight towards less specific commitments, at a realistic level which governments could credibly be expected to observe in present circumstances. However, the latest text circulated in Geneva bears little sign of Community success in this field as yet. We continue to press the Commission to try to get in language pointed specifically at the problems Japan creates for the world trading system, but most Member States do not see this as a priority.

In spite of the deeply divergent basic positions, informal discussions on a detailed safeguards agreement continued in August. In September the Commission secured the more or less reluctant acquiescence of the Member States in advancing a limited version of unilateral selectivity securing some recognition of which has been EC policy since 1978. This phase of negotiations apparently finished around the end of September when the developing countries, not seeing any benefit for them in any achievable safeguards agreement, rejected not only unilateral selectivity but consensual selectivity (ie with the agreement of the party concerned).

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The political priority of the subject is such that, some delegations seem unable to face failure, however, and informal discussions continue, if only in search of enough agreement to save face and avoid having to admit complete failure publicly. The Commission favour further study of the catalogue of safeguard measures and grey area measures. The Danish Presidency are pressing that the EC should throw its hand in completely on unilateral selectivity, but the great weight of opinion favours maintaining the EC's position on this, even if others will not accept it. The issue will certainly figure strongly in discussion at the October FAC.

AGRICULTURE

During the meeting of the CG18 (6/8 October), there were signs of a developing consensus for a solution based on: more transparency; examination of measures relating to access to markets, export subsidies and assistance and national agricultural policies; an examination of the balance of rights and obligations in this sector including waivers and other exceptions; development where necessary of common understandings of the scope of GATT provisions, and establishment of a committee to do this work. Drafting of a text remains a very delicate task. Both the Commission and the United States have been too ready to assert extreme positions as "bottom line". The possibility under GATT Article XVI.5 of reviewing industrial subsidies in parallel has been raised, perhaps only tactically. It does look as if in this sector a possible route to agreement, albeit across a tightrope may be appearing.

DEVELOPING COUNTRIES

The objectives of developing countries include better access for tropical products, reduction or elimination of quantitative restrictions and of the effects of tariff escalation, and a return to normal trade rules in the textile sector. Developed countries are keen to get better access to NIC markets and the United States has sought to get this by direct use of the lever of threatening withdrawal of GSP access. The EC has agreed upon a three point plan: specific measures in favour of the least developed countries, support for developing countries' efforts to develop mutual preferences, and a "feasibility study" to see whether a basis can be found for a round of negotiations later, in which reciprocity would be required from those capable of it, eg the NICs. On the one side tariff escalation and tropical products requests, and on the other side progress towards graduation could be worked into this approach. Although a slower route than we would wish, it appears the only realistic one at the moment for progress at the multilateral level towards persuading NICs to open up their domestic markets, giving opportunities to advance these objectives in the medium term.

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DISPUTE SETTLEMENT

We attach importance to progress in this area, as the delaying tactics employed by the United States defending their illegal export subsidy scheme (DISC) have brought the system into some disrepute. Agreement on strengthening conciliation to facilitate agreements which will avoid formal panels appears possible. More difficult is the question of the consensus forming mechanism. The question is how the party found against can be prevented from blocking consequent GATT action: The Commission approach is that panel reports which amount to new GATT obligations should not be binding on those who disagree, but in other cases there should not be a veto. There had appeared to be an agreed EC position but on 15 October Belgium led a group of Member States (who have in common defensiveness about aspects of the CAP) in insisting that the party found against should have a veto. The point may go to the October FAC.

SERVICES

Here the United Kingdom shares the modified United States position, according to which the GATT should start studies on services, with, to our mind, a view to possible later liberalisation negotiations. The rest of the EC are much cooler. This is now politically a top priority for the United States; it remains to be seen whether and how they can overcome continuing developing country opposition to GATT beginning to move into the services field, which would be a new one for it.

19 October 1982

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Treasury Chambers, Parliament Street, SW1P 3AG
01-233 3000

Prime Minister ①

Agree to the

work at X

in para 4?

PLS 22/10

Yes no

PRIME MINISTER

EXPORT CREDIT SUBSIDIES AND RISKS

At our discussion with the Governor on 1 September about the international financial situation you asked for a note on how to limit the growth of subsidised export credits and the escalation of competitive export subsidies, with a view to tightening up the criteria for lending to countries of doubtful creditworthiness. More recently Cabinet (CC(82)41st Conclusions) has invited the Secretary of State for Trade, in consultation with myself, to review the present level of ECGD exposure worldwide.

2. As you know, I largely share the concerns which underlie both these requests. But there are practical constraints on the measures open to us to limit the costs and risks of ECGD operations. And in considering the options we must obviously pay very careful attention at the present time to both the domestic and the international implications of any moves we decide to make.

3. Although I deal in this minute with both subsidy costs and credit risks it is as well to keep in mind that these are two rather different issues. There is no necessary connection between the level of subsidy which has to be offered with a contract and the degree of risk involved, except in the general sense that the OECD Consensus arrangements permit a higher level of interest rate subsidy for exports to the poorer countries.

Subsidy Costs

4. Limiting the growth of subsidised export credit, and the escalation of competitive export subsidies, is the *raison d'etre*



of the OECD Consensus arrangements. The arrangements are not 100 per cent proof against cheating, but we monitor closely what others - particularly the French and the Japanese - are doing, and it is important that we should continue to do so. Prior to November 1981, the going rate for many officially supported export credit contracts was 7½ per cent, implying a heavy subsidy cost for most currencies. Increases in Consensus interest rates were agreed in November 1981 and July 1982, and interest rates have recently been falling. The result is that the agreed minimum rates for officially subsidised export credits to rich countries are now at a level (over 12 per cent) which eliminates interest rate subsidy for most currencies.

But not for
high inflation
countries & France
& Italy, with
high interest
rates, are paying
large subsidies.

MCS

5. There is to be another round of negotiations within the Consensus framework next spring. Our general approach to these negotiations, and in particular the view we take on the need for further changes (up or down) in Consensus interest rates will depend, among other things, on the international interest rate climate at the time and our judgement of the impact of such changes on the world trading climate. If interest rates in world markets remain at or below their present level I think one of our priority objectives at the next Consensus round should be to seek agreement on arrangements to prevent the re-emergence of high subsidy costs on future business if interest rates should rise again in future. Indeed, it will be for consideration whether we should not take the opportunity to support the introduction of permanent arrangements to require credits for rich countries to be provided on an unsubsidised basis.

6. There are also some steps we could take on a national basis to improve our control of export credit subsidy costs. The following in particular seem to me worthy of examination:-

- (i) Setting a maximum acceptable rate of subsidy in net present value terms for any individual export credit project; and a separate limit on the total subsidy level in ATP cases. The limits could not



be mandatory, but would act as a trigger for special consideration (normally by Ministers) of any proposal to exceed the limits.

- (ii) The hardening of export credit terms in individual cases or in particular markets or sectors should be considered where this can be achieved without undue loss of desirable business. I understand ECGD are already reviewing the options under this head.
- (iii) Close monitoring of the interest rate support scheme in order to trigger a review if the gap between UK market rates and Consensus guidelines begins to widen.

Credit Risks

7. I understand that the Secretary of State for Trade will be circulating a note by ECGD, reviewing their worldwide exposure position and describing their present system of country assessment and controls. As regards the problem of credit risk and country exposure, I recommend:-

- (iv) A more rigorous approach to the setting and observance of the "country limits" applicable to Section 1 (Commercial Account) and Section 2 (National Interest) operations of ECGD.
 - (v) More weight to be attached to considerations of country risk in considering proposals for ECGD Section 2 cover with the aim of directing support towards countries with more favourable repayment prospects.
8. I also think the following measure would be worth examining:-
- (vi) Fixing a limit on ECGD's total Section 2 exposure in the riskier markets which would trigger a



general review of the Department's exposure under its "national interest" operations.

Conclusions

9. Some of the above proposals need more work before they can be turned into useful operating guidelines, taking account of the work which EX(0) is currently doing on criteria at the request of Ministers. I suggest that Treasury and ECGD officials, together with other departments concerned, should now be asked to undertake that work.

10. These changes will not eliminate the need for difficult decisions by Ministers in all cases. Under present arrangements there is an inherent potential conflict between ECGD's responsibilities for trade promotion, and its responsibility to operate commercially and at no net cost to public funds. In the last resort the balance between these objectives is bound to be a matter of judgement, but I think it important that we should all give full weight to prudential considerations in deciding how this balance should be struck.

11. Finally, I would emphasise that I am not seeking to attack officially supported export credit in general; I fully recognise its importance both to domestic industry and to the climate of world trade. Nor am I seeking to pre-empt, for example, Arthur Cockfield's conclusions on the interesting report which I see the CBI have just produced on ECGD. But at a time when over-indebtedness is threatening the stability of the international financial system I believe that more emphasis on the prudential and financial aspects of the export credit business would be to our advantage and in the long run to the advantage of our trading partners as well.

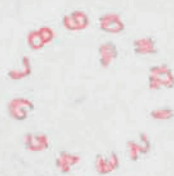
12. I am sending copies of this minute to other members of EX, and to Sir Robert Armstrong.

G.H.

ECON POL : Indebtedness of various countries

+ its effect on the

Western Banking System
Aug 82



OCT 1982

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III

Trade



10 DOWNING STREET

Prime minister

1

The Chancellor would welcome your views on where the attached paper might be discussed by colleagues. He is inclined to think that E(x) is too heavily weighted in favour of Trade ministers, and would prefer an ad-hoc group or E.

Would you be content for it to be circulated to E? NOTE

After speaking to the Prime Minister I have told the Chancellor's office she would support a decision to circulate this to E. WJ



Treasury Chambers, Parliament Street, SW1P 3AG

01-233 3000

PRIME MINISTER

EXPORT CREDIT SUBSIDIES

I would like to consult you about the position on export credit subsidies which is described in the attached paper.

2. Although I am as conscious as anyone of the need to increase exports and to help British firms to face international competition, the fact that the cost of ECGD's interest support programme has risen from £220 million in 1978-79 to an estimated £700 million in 1982-83 must raise some fundamental questions both about the total subsidy bill for capital exports and about the scale of subsidy in some individual cases. It is not clear to me that this is necessarily the most cost-effective way of preserving or creating jobs, or that it is wise to make particular sectors of industry so heavily dependent on subsidy, without in this case any particular plan to phase the subsidy out.
3. The proposals in the paper are essentially gradualist. They do not envisage any abrupt change of policy. They propose some limits, and some more selectivity and restraint. They would allow for flexibility while putting a firmer question-mark over the more extensive subsidy cases.
4. The paper is in a form in which it could be circulated to colleagues in an appropriate Committee but I would like if I may to discuss it with you before going any further.

(G.H.)

2 August 1982

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EXPORT CREDIT SUBSIDIES

I am concerned about the scale of our export subsidies for capital goods. Government support for some recent export contracts has reached (in present value terms) a rate of 50% or more of the value of the UK element of the contract - before taking account of the increasingly real possibility of payments delays or losses through rescheduling or default. The biggest Government subsidy is the interest support available automatically from ECGD to enable exporters to price on the basis of a fixed interest rate below market rates. In 1978-79 ECGD's interest support subsidy cost £220 million; the estimate for 1982-83 is about £700 million, and other subsidies are provided from the Aid Programme and under the Industry Act. Thus in four years this has become a major public expenditure programme. A forward policy on export risks and subsidies is also likely to weaken the finances of ECGD's normal insurance operations, thus either adding to premiums to the generality of exporters or swelling the PSBR.

2. Export subsidies on this scale have other disadvantages. Part of the benefit goes to overseas purchasers. The UK gets no benefit, either in employment or other ways, from that element. The subsidies are not directed so as to have the greatest effect on output or employment and are indeed a very expensive way of preserving or creating jobs. They supported only 5% of exports in 1980/81 and go mainly to certain capital goods industries with a heavy weight towards a small number of firms, which are liable to become rather heavily dependent on them. There is also the general point that the taxation or borrowing to finance these subsidies is likely to put up costs and destroy employment elsewhere. These points are further discussed below. The table attached to Annex 1 shows certain projects in the past few years that have involved very high rates of subsidy. The scale of the problem can be seen from the fact that the 33 per cent subsidy involved in the Polish ships case of 1977 is lower than all the other subsequent cases listed, which show an average rate of subsidy of over 50 per cent.

Annex 2 shows that a relatively small number of UK companies are responsible for contracts that have received a very high proportion of the export subsidies.

Advantages and Disadvantages of Export Credit Subsidies

Balance of Payments Support

3. The balance of payments argument for export credit subsidies is similar to the one used for attributing a "shadow" price to the value of foreign exchange earnings, ie. that such earnings are worth more to us than the present exchange rate implies. But this argument is irrelevant to the present situation of the balance of payments, and inconsistent with our belief in freedom from exchange controls and a market exchange rate.

Industrial and Employment Support

4. It may be said that export credit subsidies are needed to offset the effects on industry of a high exchange rate. But such subsidies have to be paid for by the rest of the community, including the rest of industry, and a significant part of the subsidy (more of it as the scale of subsidy rises) in fact goes to benefit the overseas customer. £700 million of subsidy requires £700 million of extra taxation or borrowing. The generality of industry, which in fact is having more difficulty in fighting imports than in maintaining exports, can be hit by the cost of such subsidies either directly through taxation (eg. NIS); or through the effects of higher personal taxation on wage costs; or through higher interest rates. The extra exports obtained as a result of the subsidy of course create employment, but they require extra finance for use during production and pending payment by overseas customers. This requirement competes with other demands for finance within the monetary target, whether the additional finance is bank credit or part of the PSBR. The competition will crowd out other credit demands and tend to raise interest rates. The conclusion on both the subsidy and the financing must be, as we have said so often in relation to subsidised activity of all kinds, that industrial assistance and the creation of employment by this route inevitably means burdens and a loss of employment elsewhere.

5. Export credit subsidies are therefore vulnerable to the main criticisms to which all attempts to subsidise employment and output are liable. Indeed

some of these criticisms apply to export subsidies with even greater force than they do to other fiscal measures. Treasury estimates suggest that in terms of the cost per job export credit subsidies tend to be five to ten times more expensive than other forms of direct employment assistance, and in certain circumstances the comparison can be even more unfavourable for export subsidies. Annex 3 summarises the most recent estimates of cost per job of export subsidies and certain other forms of public expenditure to assist employment. The table attached to Annex 1 includes estimates of jobs created or preserved by particular projects, but these are estimates made by the companies and do not represent a reliable estimate of the effects of particular projects on employment.

6. The benefit of export credit subsidies is confined to a small, random group of UK manufacturers and their overseas customers. If our concern is with industrial costs it may be better to concentrate on measures to reduce industrial costs generally through tax relief rather than heavy subsidy to the few.

7. Another possible case for export subsidies is the one sometimes advanced on industrial grounds. It is said that the heavy capital goods industries which derive most of the benefit from export credit subsidies have a strategic value to the future of British industrial performance which is greater than their contribution to output or exports might suggest. Moreover some of the industries concerned are located in areas of high unemployment.

8. But the level of subsidy in medium and long term official export credit is extremely costly and is well above the levels judged acceptable for direct support of industrial restructuring eg. under the Industry Act. Moreover export credit subsidies are unselective. They do not differentiate between the potential or profitability of the companies which receive them; they support the current operations rather than the capital development of these companies. Unlike domestic industrial subsidies they are not conditional on restructuring or improvements in productivity. If export credit subsidies support strategic sectors it is more by accident than design.

Subsidies as a form of protection

9. While we have been prepared to contemplate selective and ad hoc restrictions on certain categories of imports, we have not wished to encourage protection or the retaliation or emulation that it is likely to cause. Export credit subsidies are, of course, a form of protection for domestic output and employment in the capital goods industries, but in addition they are a form of subsidy which involves both direct and indirect losses to the UK economy. Part of the subsidy is captured by the foreign importer. Having acquired their capital goods at subsidised prices the importing countries can then use the equipment to compete with the UK on terms which UK industry may find difficulty in matching (as for example in the case of the Polish ships contract a few years ago).

Matching Overseas Competition

10. In the eyes of the capital goods industries the case for export subsidies is simple and compelling: the need to match terms offered by their overseas customers. But from the national point of view it is by no means clear that it is right to pursue a policy of matching if that produces substantial losses financed out of the public purse. There must be an upper limit to what it is worth subsidising. And we are not well placed nationally to engage in competitive subsidising any more than in competitive protectionism. We are more exposed and less able to afford such a race than many of our competitors. It is already clear that a competition in subsidies has entered into several major capital projects recently (eg. in Morocco and Mexico).

11. It is sometimes suggested that interest support from ECGD is needed to enable industry to compete on terms of equality with competitor countries which subsidise their export credit rates and with Japan and other low interest rate currency competitors. But most purchasers can take the prospects of currency change into account as well as the interest rate. A sterling interest rate may still look more attractive than a lower yen interest rate if the yen is expected to appreciate substantially over the life of the contract.

Maintaining UK export markets

12. A variant of the argument about matching is that some heavily subsidised contracts are needed to maintain a UK presence in overseas markets. In other words, the cost of export subsidies should be seen not in relation to the 5 per cent of UK exports which they support directly, but as an inescapable overhead of total UK export effort. But the notion that heavily subsidised capital goods

exports are an essential "loss leader" for the rest of British exports cannot be substantiated from the evidence any more than the contrary view that each increase in the level of subsidy which HMG is prepared to offer to gain a big export contract reduces the future prospects of non-subsidised export business in the markets concerned.

The current case for subsidies: A possible presentation

13. It is perhaps possible to present a case for these subsidies on an amalgam of arguments. The first is based on confidence that - as a result of the success of government economic policies - interest rates will fall and the cost of subsidies will turn out to be significantly less than is currently expected on the basis of long-term yields. Coupled with this, there is the argument referred to in paragraph 4 above that the subsidies are needed to give temporary protection to British industry during a period of high real exchange rates which may be regarded as transitional. Thirdly, to the extent that the subsidy takes the form of a charge on the Aid Programme, that may be regarded as substituting for ordinary bilateral aid within a fixed total programme, and in this sense as costless in public expenditure terms.

14. While it is certainly our aim to achieve lower interest rates and we are now making progress in doing so, we cannot count on this to remove the subsidy burden. The future course of interest rates, over the whole life of projects now coming into subsidy, is not wholly within the UK's own control. And if inflation is not to rise again, there may have to be a real return to savers and thus significant real interest rates world-wide. As to the case for subsidies as temporary assistance to industry, their particular incidence is less satisfactory than a more general reduction of industrial costs, and indeed reduces the pressure on the firms concerned to squeeze their own costs. Finally, the argument about adjusting priorities within the Aid Programme takes no account of the substantial costs of ECGD subsidies involved in mixed credit packages, which represent a straight addition to public expenditure.

Conclusions

15. The attractions of matching some of our competitor-subsidised export credit offers and winning some of the export contracts available are more apparent than real. In many cases the size of subsidy required is such that the contracts are not worth winning. And we are creating a situation in which part of the capital goods industry is depending on subsidy (and on lobbying for subsidy) for its continued existence.

16. In short this area of subsidy betrays all the features which the Government has set its face against in its supply side policies: a growing public expenditure bill in an open-ended expenditure programme, a large subsidy with unclear objectives which is not cost-effective and a part of industry becoming a pensioner of the state at the cost of substantial (employment-detroying) taxation levied on the rest of the economy.

Controlling the Costs

17. Our long-term objective in this field should be to support the multi-lateral phasing out of export credit subsidies through the OECD Consensus. Most OECD governments are already committed to this policy, the US and the Australians being perhaps its most enthusiastic advocates. But even the latest changes in Consensus rules still leave considerable scope for subsidising.

18. Export credit subsidies are not the only example of an open-ended public spending programme. But they have certain characteristics which make them even less amenable than other programmes to the influence of normal public expenditure control mechanisms. One is the length (and unpredictability) of the time-lag between the time when government support for a contract is committed and the time when the costs of that support emerge in the estimates and public expenditure figures. Another is that unlike other cases where the rules which determine expenditure are fixed (often by Parliament) the rules for export credit subsidies are to a considerable degree ad hoc and flexible, and are not subject to any form of Parliamentary authorisation or control. Nor is there proper accountability for the cost of export credit subsidies. This is especially true of the most heavily subsidised projects where ECGD is apt to have to foot the bill for proposals passed by other Departments.

19. Ideally any control mechanism would be directed to the cost of the subsidy element in export credit commitments, in aggregate and in relation to individual contracts. But the cost of past commitments can be changed uncontrollably by movements of interest rates, making nonsense of cash control. A possible approach would be via a combination of measures on the following lines:-

- a. A rolling annual limit on ECGD's total exposure under the fixed rate credit scheme. This need not be an absolute limit but would represent a trigger for consideration of whether aspects of the scheme needed to be adjusted.

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- b. Fixing a maximum acceptable level of subsidy in net present value terms for any individual case; and a separate limit on the total subsidy level in ATP cases.
- c. Selective hardening of export credit terms for particular markets or sectors. It is wrong to give automatically the full extent of the subsidy permitted by Consensus rules on contracts in all markets and industrial sectors.
- d. A tougher line on 'country limits' for offers of support under Section 2 of the 1978 Act (the 'national interest' provision) with the aim of directing the available total of export credit support towards countries with more favourable repayment prospects.

20. If this approach is agreed, officials could be invited to work out more precise formulae to give effect to (a)-(d) above.

SUBSIDY LEVEL OF SPECIFIC EXPORT CONTRACTS

The attached table gives details of recent bids by UK companies for major overseas contracts involving very high subsidy levels. It shows the impact of the various forms of government support on the total level of subsidy incorporated in each bid, expressed as a percentage of the value of the UK element of the contract.

2. Subsidies made available under the Industry Act, the Science and Technology Act and the Aid and Trade Provision (ATP) are normally on grant terms. But the largest form of export subsidy - expenditure on interest support by ECGD - involves a stream of payments to the banks over the period of the export credits to meet the difference between the fixed rate of interest paid by the borrower and the agreed return to the banks, which is a margin over short term money rates. These expected future payments can be discounted back to give an estimate of subsidy costs in net present value terms.

3. The level of subsidy can build up substantially if modifications to the basic fixed rate export credit facility are allowed. To take a specific example, assuming a fixed rate loan of 11% and a market rate of 14%, an export credit with a 15% downpayment, a four year draw down and an eight year repayment period results in a subsidy level of 10.0%. This subsidy level increases:-

- (a) to 11.8% if credit is provided for local costs equal to 15% of UK content
- (b) to 14.9% if in addition the repayment period is extended to fifteen years and
- (c) to 17.8% if in addition the interest accruing during the draw down period is capitalised.

4. An example shown in the attached table of the high levels of subsidy which can result solely from use of ECGD's interest support programme is the Hong Kong Island Line railway contract (43%). The effects of combining ECGD and ATP subsidies are seen in the Indonesian hydro-electric power project (52%) and the Zimbabwe railway contract (56%). In the bid for the Mexican Sicartsa I contract, which was awarded to the UK, ECGD and ATP subsidies were combined with a subsidy under the Science and Technology Act, giving a total subsidy level of nearly 65%.

5. All these subsidy figures take no account of possible additional Exchequer costs, through payment of claims by ECGD, which could result from defaults on credits.

CASES INVOLVING EXCEPTIONALLY HIGH SUBSIDY ELEMENTS

Date	Country	Project	Value of Exports	ECGD Terms	Local Costs	ATP	Other Assistance	Subsidy	Companies' estimates of jobs created or preserved	Comment
1977	Poland	24 Ships	\$142.3m	7½% over 7 years for 70% (\$100m) of loan.	£9.55m	-	B.S. guarantee for Eurobond borrowing of \$65m. Intervention Fund Subsidy of £28m.	33.6%	-	
1981	India	Coastal Steel Plant	£780m	85% of UK goods at 7½% over 10 years with 5 years' grace.	£50m (RTA)	-	£125m ODA grant and special Industry Act support of up to £20m. agreed.	54.3%	50,000 man years	Proposed offer of buy back agreement. Contract lost.
1981	India	1) Thermal Power station and 2) Associated coal mine	1) over £368m 2) £134m.	1) 7½% for balance of UK content over 10 years	-	£65m plus £75m FTA	-	73%	40,000 man years	HMG side agreement to increase bilateral aid and Ministerial decision to waive pro rata provisions in IBA agreement. Terms of 2) still under discussion.
1981	Kenya	System X	£13.7m	85% of UK content at 10% over 8 years	-	£6.85m	-	ATP 44.5% ECGD 9.9% 54.4%		
1981-2	Mexico	Sicartsa I	£232.5m	85% of UK content plus 15% locals and EC element at 7½% over 15 years.		£34.9m.	\$5m grant under Science and Technology Act	ATP 22.1% ECGD 40.3% PPDS 2.2% 64.6%	25,000 man years	Contract Won.
1981-2	Mexico	Sicartsa II	£68m	85% of UK content and eligible EC (German) costs and local costs: 7½% over 3 years' grace	£41m. (financed in DM up to 15% of UK and eligible £ (element))	-	Authority given to use ECGD S.3 matching facility.	39.8% excluding S3 assistance 44½% with 7% interest on UK element.	-	Contract lost.
1981	Hong Kong	Rail cars for Island line and for Kowloon-canton railway	£55m) £60m) £17.5m	8½% over 8½ years with capitalisation of interest. Cash contract: no ECGD cover	none	-	- PPDS £3,507m) 43%) -	N/A	The PPDS assistance for the cash contract enabled Metro Cammell to quote a lower price

Date	Country	Project	Value of UK Exports	ECGD Terms	Local Costs	ATP	Other Assistance	Subsidy	Companies' estimates of jobs created or preserved	Comments
1981	Hong Kong	Castle Peak 'B' Power Station	£755m	8½% interest over 12 years from date of commissioning of Units 1&2 and then Units 3 and 4.	HK\$ 1.4bn	-	CEC at half (ie. 1%) premium rate at cost of £0.8m. S.7 assistance for consultancy services - £20m.	42%	34,000 man years.	-
1981	Zimbabwe	Railway Electrification Phase 1.	£27.46m	11% of UK element and local costs (15% of UK/third country costs) over 10 years at 2½%.		£8.239m	-	56% ECGD 23% ATP 33%	1,000 man years	Possible follow-on contract but again on ATP supported terms
1981	Indonesia	Hydro Electric power projects at Mrica and Maung	c.£50 m.	7½% over 10 years plus local costs of up to 15% of UK content		£12.075m	-	52% ATP 25% ECGD 27%	N/A	Still under negotiation

SOME FIGURES TO SHOW THE DISTRIBUTION OF EXPORT SUBSIDIES BY COMPANY

NAME OF COMPANY/GROUP listed in order of export performance with the figures in brackets giving the companies' positions in 1980 in relation to the top 100 UK exporters	BUYER CREDIT CASES with loan value over £20 million for years 1977-81		TENDER TO CONTRACT COVER current firm agreements at 28.5.82		COST ESCALATION SCHEME issued agreements to date (13.7.82)		ATP CASES APPROVED IN 1981		INDUSTRY ACT AND SCIENCE TECHNOLOGY ACT. Current approved offers at 13.7.82	
	No of cases	total loan value	No of cases	ECGD's maximum payment liability	No of cases	net cost to ECGD	Offers approved	Amount of ATP involved where offers accepted	No of cases	Amount of assistance involved where offers accepted
GMV (5)	7	1,339.11	14	77.74	8	24.74	4			
British Aerospace (6)	3	724.30			2	3.58				
Holls Royce (10)	3	843.01			1	(0.13)				
British Shipbuilders (19)	5	289.69	2	3.14						
BICC (20)	2	234.28	4	7.71	1	1.25	4	2.87		
Davy Group (24)	4	445.72	6	75.82	5	6.72	4	34.94	2	5.00
GNV (30)	1	39.65			1	0.07	1			
Babcock (30)	1	44.40	2	7.86						
Simon Group (51)	1	62.37	2	4.64	4	0.27	1			
John Brown (54)	1	43.06	1	2.80			2			
STC (62)	1	159.08					2			
Westlands (70)	1	36.67	3	9.20						
Cementation (Trafalgar House)	2	66.92					2			
Natro Carrall (Laird Group)	1	68.25	3	24.55	3	7.49			1	
Klockner	2	65.51	2	36.78			1			
Total	35	4462.02	39	250.26	25	43.99	21	37.81	5	5.00
Total of other companies	23	1105.13	7	47.41	-		14	-	3	12.66
Grand total	58	5,567.15	46	297.67	25	43.99	35	37.81	8	17.66

* including one case with Balfour Beatty (BICC) and Westinghouse.

ESTIMATES OF COST PER JOB

All estimates of costs per job are subject to substantial margins of error. In most cases it is likely that some, and possibly a large proportion, of the employment "created" by a measure would have occurred anyway, or merely displaces employment elsewhere. It is difficult to estimate the precise size of this "displacement" effect. Assumptions also have to be made about how long a job will last and how one should compare the cost of a stream of subsidy payments with a lump sum subsidy (ie through the use of a discount rate). The following figures must therefore be regarded as broad orders of magnitude. Moreover, they are not strictly comparable in that the estimates for regional policy incentives and export credit subsidies are for extra employment, but those for selective employment measures are for the gross cost per person off the unemployment register. Changes in employment tend to be associated with smaller changes in the number unemployed.

DIRECT COSTS PER JOB OF MEASURES TO REDUCE UNEMPLOYMENT

<u>Scheme</u>	<u>Source of estimate</u>	<u>Estimate of cost per job year in 1982</u>
1. Regional policy* incentives in the 1960's and 1970's	Published DOI material with adjustments for displacement effects	£16,000
2. Short-time working compensation scheme	Treasury estimate	£7,000
3. Job replacement scheme	Treasury estimate	£4,000
4. Youth Opportunities Programme	Treasury estimate	£3,700
5. Job splitting scheme+	Treasury estimate	£600-1100
6. Export credit* subsidies (effects of a 15% subsidy)	A range of Treasury estimates based on alternative assumptions about employment in the absence of a subsidy and the extent to which the subsidised exports are additional	£50-200,000

Notes * Effect on employment

+ There is no evidence yet on which to base the estimates of the cost of the job splitting scheme. These figures assume that the subsidy will be £500 or £1000 and that the deadweight loss is only 10%. It remains to be seen what the take up will be.

Prime Minister (2)

MR. SCHOLAR

A new interpretation of the
import figures we have been using.

IMPORTS

MUS 27/7

One feature that has not been noticed in the comment about the increase in the volume of imports is that the quantity of capital goods imported has increased more than twice as fast as the volume of finished consumer goods. In the January/May 1982 period imports of capital goods were 40% higher than in the first quarter of 1981. The corresponding figure for finished consumer goods was less than 20%. It is also noteworthy that intermediate manufactures, such as steel castings, and sub assemblies, have increased at about the same rate as capital imports.

This means that the import scenario is much less worrying than appears at first sight. Most of the capital imports will comprise British firms purchasing the best technology they can get hold of. And since we are a small part of the world market in manufactures, one would expect most of it would have to be imported. It confirms then that British industry is being re-equipped and with the most up-to-date imported technology.

ALAN WALTERS

27 July 1982



Secretary of State for Industry

DEPARTMENT OF INDUSTRY
ASHDOWN HOUSE
123 VICTORIA STREET
LONDON SW1E 6RB

TELEPHONE DIRECT LINE 01-212 3301
SWITCHBOARD 01-212 7676

30 June 1982

Lord Cockfield
Secretary of State for Trade
1 Victoria Street
London SW1

N. S. P. R.

A. J. C. 4/2

f.a.

Dear Arthur,

GATT MINISTERIAL MEETING

I was interested to read your letter to Francis Pym on 17 June, with the attached note by officials, and can sympathise with your difficulty in making firm recommendations on our line at this relatively early stage. I am broadly content with the line suggested on the various issues but there are one or two points of particular interest to me on which I should like to comment.

2 The first relates to the developing countries, in particular the newly industrialising countries (NICs). The domestic pressure to which you refer for us to be seen to be doing something about the privileged position which some of these countries enjoy is very real. I can see the difficulties which you mentioned about advancing in public policies which would accentuate distinctions between developing countries; at the same time I feel we must take the opportunity of this high level meeting to increase pressures on the NICs to take on more of the standard GATT obligations accepted by developed countries. I would, therefore, hope that we can use the American initiative mentioned in paragraph 18 of the paper by officials, however ineptly it has been put forward, to focus attention on this point.

3 My second comment concerns Japan and your suggestion that the work on safeguards envisaged could produce useful results in relation to the current imbalance in our trade with Japan. As you know, there is very strong pressure from industry that the Community should take a much tougher line over this imbalance. None of us have much expectation that the Article XXIII procedure will make for significant changes in the short term. I therefore consider it important that we should not be led into accepting any new agreement or code on safeguards which might damage the voluntary restraint agreements we have with Japan



which help to limit the extent of the imbalance in certain key sectors like vehicles. We have already seen evidence in the reaction of the Japanese Government to moves towards greater transparency in GATT in relation to VRAs that they are very nervous about greater international scrutiny and control of the existing arrangements. Since there does not seem to be any prospect of negotiating tougher safeguard arrangements, I think we need to work out with some care the negotiating position which we will wish to see the Community take, so that we do not weaken the defences we have against a surge in Japanese imports in the name of transparency.

4 Another reason for concern about the position on safeguards is the possibility, however remote, that the current bilateral negotiations under the MFA will fail and that the Community will then have to withdraw from the Arrangement. In this event the Community would need to have the "massive recourse to Article XIX measures" mentioned in paragraph 8 of the paper as the alternative to the MFA. It does therefore seem to me that we need to be very cautious about changes in relation to the existing arrangements on safeguards, whatever pressure we may come under to make progress in this area. I trust that there will be further opportunity for Departments to consider safeguards before any firm decisions are made on the UK line.

5 More generally, and in parallel with the point I made above about the NICs, I feel we must maintain our efforts to get changes in existing Japanese trading practices. Industries currently threatened or being hit by Japanese imports are looking to us to use every opportunity - and the GATT Ministerial Meeting may provide such an opportunity - to bring much more effective pressure on Japan to take steps to liberalise her own import policy and play fair in international trade.

Yours
Peter

130 JUN 1982

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c HMT Trade

10 DOWNING STREET

THE PRIME MINISTER

28 June 1982

Alan Arnold

Thank you for your letter of 9 June.

I hoped my letter of 26 May would allay your fears about the possible outcome of the present round of Consensus negotiations and the risks to our export competitiveness of agreeing to lower interest rates for yen financing.

I accept that in order to offer comparable terms to those made by Japanese exporters, UK and other countries' exporters must be able to raise yen finance in sufficient amounts to on-lend at the special Consensus rate where this is attractive to the buyer. Since our earlier correspondence you will have seen Peter Rees' announcement of new ECGD facilities to assist UK exporters wishing to finance export contracts in yen to match Japanese offers. This follows an agreement reached with the Japanese authorities on access to the Tokyo market. While it is too soon to say categorically that no difficulties will arise, the Japanese authorities have not placed any formal ceiling on this borrowing and we have no grounds for supposing that they will not honour their undertaking to allow international access to their domestic market to finance export credit transactions. However, if this proves not to be the case, we and our Community partners would act promptly to correct any injustice.

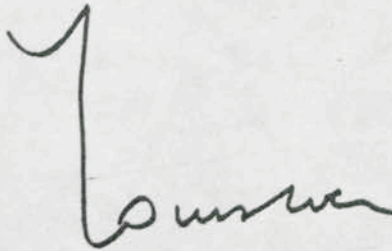
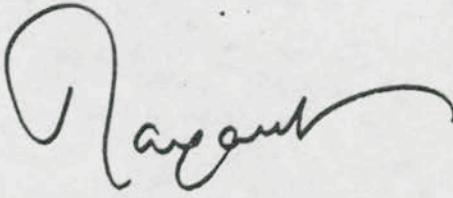

As you will be aware from recent press reports, the negotiations on changes to the Consensus are still in progress, and the final outcome is still unclear. As a member of the Community and in the course of discussions within the Consensus Group and elsewhere

/I can assure

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I can assure you that the UK has sought to safeguard the interests of our exporters and at the same time has attempted to influence discussion in the direction of a workable solution which will remove the threat of an escalating credit race.

Your suggestion that Consensus interest rates should be pegged for the time being is, I fear, one that is simply not negotiable with the other participants. Although pressure from the Americans to increase Consensus interest rates may diminish if their domestic rates fall, the real argument is over the extent (if at all) that official interest rate subsidies are given. It has been generally accepted for some time that the consensus interest rate matrix no longer reflects the market interest rates of participant countries. As a result the degree of subsidisation of officially supported export credits has increased rapidly in the past few years, particularly in France and Italy as well as the UK, and the proposals to adjust the Consensus matrix are aimed at redressing the balance.

The Lord Weinstock



29p
Trade

Treasury Chambers, Parliament Street, SW1P 3AG
01-233 3000

25 June 1982

Michael Scholar Esq.
10 Downing Street
LONDON
SW1

Dear Michael,

.... I attach a draft reply for the Prime Minister to send to Lord Weinstock. When I spoke to you last Friday, I said that we hoped that the negotiations might be concluded this week, so that the Prime Minister could respond in rather different terms. But as you know the emergency ECOFIN on 23 June failed to produce agreement. I attach a reply which effects this.

Yours sincerely,

Jill Rutter

JILL RUTTER

DRAFT LETTER FROM: PRIME MINISTER
TO: LORD WEINSTOCK
GENERAL ELECTRIC COMPANY LIMITED

Thank you for your letter of 9 June.

2. I hoped my letter of 26 May would allay your fears about the possible outcome of the present round of Consensus negotiations and the risks to our export competitiveness of agreeing to lower interest rates for yen financing.

3. I accept that in order to offer comparable terms to those made by Japanese exporters, UK and other countries' exporters must be able to raise yen finance in sufficient amounts to on-lend at the special Consensus rate where this is attractive to the buyer. Since our earlier correspondence you will have seen Peter Rees' announcement of new ECGD facilities to assist UK exporters wishing to finance export contracts in yen to match Japanese offers. This follows an agreement reached with the Japanese authorities on access to the Tokyo market. While it is too soon to say categorically that no difficulties will arise, the Japanese authorities have not placed any formal ceiling on this borrowing and we have no grounds for supposing that they will not honour their undertaking to allow international access to their domestic market to finance export credit transactions. However if this proves not to be the case, we and our Community partners would act promptly to correct any injustice.

4. As you will be aware from recent press reports, the negotiations on changes to the Consensus are still in progress, and the final outcome is still unclear. As a member of the Community and in the course of discussions within the Consensus Group and elsewhere I can assure you

that the UK has sought to safeguard the interests of our exporters and at the same time has attempted to influence discussion in the direction of a workable solution which will remove the threat of an escalating credit race.

5. Your suggestion that Consensus interest rates should be pegged for the time being is, I fear, one that is simply not negotiable with the other participants. Although pressure from the Americans to increase Consensus interest rates may diminish if their domestic rates fall, the real argument is over the extent (if at all) that official interest rate subsidies are given. It has been generally accepted for some time that the Consensus interest rate matrix no longer reflects the market interest rates of participant countries. As a result the degree of subsidisation of officially supported export credits has increased rapidly in the past few years, particularly in ~~countries such as France, and~~ Italy ^{as well as} and the UK, and the proposals to adjust the Consensus matrix are aimed at redressing the balance.



me

Treasury Chambers, Parliament Street, SW1P 3AG

01-233 3000

24 June 1982

The Rt Hon Lord Cockfield
Secretary of State for Trade

Dear AM

Thank you for sending me a copy of your letter to Francis Pym of 17 June about the GATT Ministerial meeting.

I am content with the approach which you outline.

Copies of this letter go to the other recipients of yours.

[Handwritten signature]

GEOFFREY HOWE





RM

Trade

10 DOWNING STREET

From the Private Secretary

21 June, 1982

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Trade
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m/s FCO
RTA

THE GATT MINISTERIAL MEETING

The Prime Minister read over the weekend your Secretary of State's letter of 17 June on this subject. Subject to the views of OD(E) colleagues, she is content with the general approach which Lord Cockfield describes.

On page 4 of his minute, Lord Cockfield refers to certain topics on which the United States is laying emphasis. Mrs Thatcher has commented that these topics (trade in services, investment issues, trade in high technology products and counterfeiting) are all very important to us.

I am sending copies of this letter to the members of OD(E) and to Sir Robert Armstrong.

A. J. COLES

J Rhodes, Esq
Department of Trade

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From the Secretary of State

CONFIDENTIAL

The Rt Hon Francis Pym MC MP
 Secretary of State for
 Foreign and Commonwealth Affairs
 Foreign and Commonwealth Office
 Downing Street
 London
 SW1A 2AL

Prime Minister

Content will then general
 approach to the November
 GATT meeting, subject to the
 views of OD (E) colleagues?

A.F.C. 4/6

Yes
 M.I.

17 June 1982

Dear Francis,

THE GATT MINISTERIAL MEETING

The Contracting Parties to the General Agreement on Tariffs and Trade (GATT) are to meet in November 1982 at Ministerial level for the first time since 1973, as was decided last year in the framework of the Ottawa Economic Summit. This will be an important meeting, as the open multilateral trading system based on the principles of the GATT is under greater pressure than ever before. This was recognised at the Versailles Summit, where the declaration referred to the importance of resisting this pressure and strengthening the open world trading system as embodied in the GATT.

The EC Foreign Affairs Council is expected to receive shortly a first Communication from the Commission which will reflect the degree of progress so far achieved for the GATT Ministerial meeting. In preparation for this stage, officials have been developing United Kingdom positions on the various points expected to come up (both in the Cabinet Office machinery and in an Inter-Departmental Group on the GATT Ministerial Meeting under Department of Trade chairmanship), under the overall direction of the Minister for Trade, who will attend the meeting. The attached agreed note represents a distillation of the results so far.

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From the Secretary of State

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I recommend this note, so far as it goes, to my colleagues. I should warn, however, that it can only deal with the position as it has so far evolved. Although the bureaucratic preparatory machinery in Geneva has laboured mightily, it has not so far defined in any clear way what exactly will be the key policy issues Ministers will need to decide upon in the autumn or to delineate the possible trade-offs. It is difficult to discuss how far it will be possible in the preparatory work to elaborate or settle substantive (as distinct from procedural) Ministerial decisions. It is possible, however, to forecast what some of the key issues will be:-

- (a) the use of safeguard measures (paragraphs 8-13) was intended, during the Tokyo Round, to be regulated by a detailed agreement or code of the type that was then agreed for standards and technical regulations, Government procurement and other topics. When these negotiations broke down in the Summer of 1979, EC intransigence was generally blamed by developing countries. The issue is very contentious within the EC as it lays bare fundamental divergences between open market and protectionist approaches to trade policy. The issue has acquired an exaggerated political importance beyond its economic significance, so there is no doubt that unless at least a substantial interim agreement can be reached on this topic this year, many voices will assert that the Ministerial Meeting has failed.

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From the Secretary of State

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- (b) on agriculture (paragraphs 15-16), traditional agricultural exporters are in full cry against the CAP; the EC is accordingly on the defensive. The Commission seem to be showing some signs of tactical flexibility. Although the Community will have little room for manoeuvre, a frontal clash may be avoided.
- (c) two aspects of policy in relation to developing countries (paragraphs 17-19) will be important. It is becoming widely accepted in developed countries that policies have to be devised to persuade newly industrialising countries (NICs) over a period to adapt to the GATT disciplines as operated by developed countries. The particular language used for this in the late 1970s ("graduation") is increasingly seen as politically counter-productive, and alternative approaches are being looked at in the OECD and elsewhere. but they may not be ready by November and in any case the Ministerial Meeting is probably not the best place to advance policies that involve accentuating distinctions between developed countries. Secondly, the numerous Ministers from poorer developing countries will come with expectations that will be impossible to satisfy to any considerable degree. But it would be most unwise to send them away completely empty handed, six months before UNCTAD VI. In addition to the limited possibilities on tropical products, and whatever angles of interest to them can be developed on other topics, I understand that some tentative consideration is being given to strengthening the GATT Secretariat's technical assistance to developing countries. This is, we believe,

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From the Secretary of State

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of greater help to them than many more ambitious, political and expensive programmes in other bodies; if this idea develops, we may need to pay our share, perhaps a few hundred thousand pounds per annum. We shall naturally be in touch with the Treasury and ODA if this idea develops.

- (d) there are the United States issues (paragraphs 21-29). They have devised a set of topics rather remote from usual GATT business but responsive to their own domestic concerns, and are forcing them forward with characteristic insensitivity? The topics include trade in services, investment issues, trade in high technology products and counterfeiting. For the good of United Kingdom/United States trade relations generally we should avoid being unnecessarily negative about these ideas, and indeed some of them may reflect specific United Kingdom interests, eg trade in services and counterfeiting. But we should also ensure that it is, as far as possible, the United States which pays any price that has to be paid in GATT, especially to developing countries, for getting some of them on the table.

only very important to us.

It follows from its general shape that the GATT Ministerial Meeting is unlikely to offer major opportunities to pursue our specific preoccupations on trade with Japan. Nevertheless, work on safeguards and on services touches these preoccupations and could produce results which are helpful to our efforts to redress the present gross imbalance in our trade with Japan.

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From the Secretary of State

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Finally, I should draw colleagues' attention to a point on the wider context of this meeting. It is correctly argued that it is not modelled on the last Ministerial Meeting in 1973 in Tokyo, which launched the Tokyo Round of Multilateral Trade Negotiations. This is clearly right - for instance, the staged tariff cutting process then agreed will still have over four years to run. On the other hand there are some pressing issues which may require to be addressed in formal, if limited, negotiations before these custs are over. Leading candidates might be trade with NICs (see paragraph 18 of the note) and agricultural trade. Further, do we want to face UNCTAD VI with no GATT negotiations even on the horizon? At this stage we should, I suggest, be careful to avoid excluding too much, and keep open minds about what we might consider in the autumn in the way of limited negotiations, or talks about negotiations, after the Ministerial Meeting.

If you and colleagues are content with these orientations, we will be guided by them in the initial round of discussions in the Community, and I will make further recommendations in due course when the main points for decision are clearer.

I am sending copies of this letter to the Prime Minister, to the members of OD(E) and to Sir Robert Armstrong.

*Yours,
Arthur*

LORD COCKFIELD

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THE GATT MINISTERIAL MEETING

Note by Officials

The Contracting Parties to the General Agreement on Tariffs and Trade (GATT) are to meet at Ministerial level for the first time since the Tokyo Round of Multilateral Trade Negotiations was launched in 1973, in November in Geneva. This note presents to Ministers in summary form the main issues that are expected to arise, as a basis for consideration of the overall UK stance towards the meeting. It is not intended to duplicate the much more detailed notes that have been prepared by the Departments concerned on the individual topics and considered by the Interdepartmental Group on the GATT Ministerial Meeting under Department of Trade chairmanship.*

2 The preparatory process for the Ministerial Meeting is still at a relatively early stage in Geneva. A Preparatory Committee was established in December 1981 but only recently have attempts started to marshal the wide range of possible topics that have been suggested for Ministerial attention in a way that will be manageable for a meeting of Ministers lasting only some four days.

3 At present it appears that the issues will be grouped under three broad headings:

- (a) a political declaration, of which the centre-piece will clearly be a re-affirmed determination to resist protectionism.
- (b) a group of decisions to be taken by Ministers. This implies a group of substantial problems on which there has been sufficient progress that Ministers can settle a final outcome, or can lay down sufficiently settled guidelines that final decisions can be reached in short order. The importance of this category is that without either progress on outstanding problems, or a plausible

*The papers of this Group are available on request from International Trade Policy Division, Department of Trade, to any Department not represented on the Interdepartmental Group.

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appearance of it, the protestations in the political declaration of commitment to the open trading system and resistance to protectionism will, in current circumstances, seem exceedingly hollow.

- (c) problems which it can be agreed that the GATT needs to tackle in its work programme for the new few years.

The Community Dimension

4 The vast majority of questions addressed in the GATT are part of the common commercial policy of the European Community and hence fall under the exclusive external competence of the Community under Article 113 EEC. The pattern in the GATT is that, after establishment of a common position within the Community, the Commission alone speaks for the Community. This is broadly how the Community will approach the GATT Ministerial Meeting. But

- (a) it has been agreed that, whatever the formal position, the Ministers of the Member States will be entitled to speak. Given the divergences in the approaches to trade policy currently reigning in the different Member States of the Community, this may lead to a somewhat variegated Community approach.
- (b) trade in services, unlike trade in goods, is a topic on which external competence is divided between the Community and the Member States (and in investment matters it lies almost entirely with Member States) and it is therefore legitimate for the Member States to speak with more distinctive voices.

5 The Community preparatory process at Ministerial level is only just beginning. The latest indications are that the Commission hopes to put a Communication to the Council shortly, but not in time to be discussed at the 21/22 June Foreign Affairs Council. There will then be an oral Commission presentation by Vice-President Haferkamp, and a first Ministerial discussion. A more substantial discussion of the Commission Communication is expected in July.

Overall UK Objective

6 The prolonged recession has resulted in a period of strong and increasing protectionist pressures. So far the temptation to react to these by protectionist measures has been largely, but not wholly, resisted. Particular current tensions in the developed world are between the US and the EC on steel and agriculture, and between both and Japan. Pressure to prove the relevance of the GATT to the trade problems of developing countries will increase as UNCTAD VI (May 1983) approaches. UK interests lie in the maintenance of an open trading system and from our point of view it is therefore very important that the Ministerial meeting should show that these protectionist tendencies can be controlled. This means that we should work for a political declaration and a set of decisions on specific issues which, taken together, can be seen as an adequate response to this need. For this purpose we should try to avoid excessive advance expectations developing, and try to facilitate a successful outcome in deciding on where to put our weight in the EC, and on what adjustments to our own policies on specific points may be tolerable.

Specific Topics

7 This note now turns to consider briefly in turn the main subjects the Ministerial Meeting may be called upon to address. It is a mixture of major outstanding problems from the 1970s with new problems that, notably, the Americans are trying to put on the GATT agenda for the 1980s. Many other topics of much importance in the GATT are to some extent in a siding because they were the subject of agreements in the Tokyo Round. The relation of these topics to the Ministerial Meeting is considered in more detail in para 14 below.

Safeguards

8 Article XIX of GATT provides for emergency action, notwithstanding GATT commitments, where sharp increases in imports cause or threaten serious injury to domestic industry. As protectionist pressures have increased since the early 1970s, problems over when it is justifiable to invoke Article XIX and over measures which, though not formally based on Article XIX, have a similar protective effect, have become

of much greater importance. This problem is of the first importance for two groups of trading partners. The developing countries have seen their access to developed country markets in textiles and clothing, manufactures in which they have a substantial competitive advantage, heavily restricted through successive phases of the Multi-Fibre Arrangement, effectively an alternative to massive recourse to Article XIX measures, and fear the same could happen in other sectors as their competitiveness improves. Then there are smaller developed countries who cannot force negotiated measures having a safeguard effect on supplier countries, and fear the diversionary effect on their markets if large trading partners force such measures on Japan and other very competitive suppliers, notably in East Asia.

9 Safeguards were, undoubtedly, the great negotiating failure of the Tokyo Round of Multilateral Trade Negotiations (MTNs). The negotiations failed largely because the European Community, with the UK in a leading role at that time (1978), attached itself firmly to the concept of selectivity and the need for explicit recognition of its legitimacy. Selectivity is the idea that emergency safeguard action can be taken against the particular supplier of the surge of imports which is threatening serious injury to domestic industry and not against all suppliers, that is on a Most Favoured Nation (MFN) basis. Despite our argument that selective action was likely to be less restrictive than MFN action, the developing countries (understandably) took the view that this idea was primarily aimed at them and in 1979 in the conclusion at the Tokyo Round, and at UNCTAD V, committed themselves firmly against it. Nevertheless, viewing safeguard actions and actions with a safeguard effect as a whole, it is clear that in recent years there has de facto been a trend towards selective action.

10 Another element is "discipline". The idea that there should be more closely defined criteria on when it is legitimate to invoke Article XIX: how sharp the increase in imports ought to be, what constitutes serious injury to a domestic industry and so on. It is also argued that safeguard measures should only be taken for a limited

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time and that they should be degressive: their protective effect should diminish over time. And some seek to link the safeguard issue with structural adjustment, the idea that domestic industry which cannot compete internationally, particularly with developing country competition, should be phased out rather than permanently sustained by protective measures.

11 An element that has developed more recently is "transparency": measures having a safeguard effect, as well as formal Article XIX measures, should be on the table in the GATT and be open for (at least) consultation and discussion. Some of the measures are negotiated between industries and hence are not formally the responsibility of governments, though governments often have an important role behind the scenes in the negotiations. It seems less than sensible that measures having important trade effects, and described in the press in more or less detail, should be quite outside the multilateral framework. It is important to assess how far greater openness about such "grey area" measures in the GATT might diminish the willingness of East Asian suppliers to reach such arrangements. If this happened to a significant extent we might more often be faced with a clear decision whether or not to invoke Article XIX to protect a threatened sector.

12 The current UK position is broadly as follows:

- (a) Selectivity; in 1978 the EC was led into a relatively protectionist position because it espoused selectivity (on which the UK took the lead); formally the EC remains committed to the June 1978 mandate which proved un-negotiable in the Tokyo Round. Since 1979 the UK has been working to detach itself and EC from this point without damaging our substantive position and ability to protect UK industry where necessary, and the present Government has not committed itself

to selectivity as an important trade policy objective. Firm recommitment to selectivity by the EC or the UK would now be seen as protectionist in intention, so we should leave time and practice to establish that selectivity happens in the real world, and not press for multilateral acceptance of its legitimacy.

- (b) Discipline; we cannot accept that safeguard or equivalent measures should be subject to phasing out in a fixed timetable or to fixed criteria for the application of Article XIX. However the principle of degressivity, measures diminishing in protective effect over time, is more attractive and should encourage industry to think in terms of re-adjusting.
- (c) Transparency; offers scope for real progress. It seems desirable to get international credit for discussing, without commitment, arrangements already substantially public.

13 Safeguards is a point where many countries feel it is important to reach some agreement, even if relatively unsatisfactory, to avoid major contention and disruption at the Ministerial Meeting itself. So there may be an intensive effort to make progress on it before November. As the negotiations develop the issues will be put to Ministers for decisions. To secure agreement we may need to go further than we would ideally like, but we have to bear in mind that the negative impact of publicised failure on safeguards at Ministerial level would be very serious for the open trading system as a whole. We should not find ourselves too exposed if we aim to keep in the middle in the Community; the French and often the Belgians, Irish and Italians will find themselves in more difficulty than we do.

Tokyo Round Agreements on non-tariff barriers

14 In the Tokyo Round, agreements ("Codes") were concluded on several major types of non-tariff barriers. These agreements clarified and amplified the application of the various provisions of the General Agreement to differing types of non-tariff barrier to trade. The agreements covered Technical Barriers to Trade, Government Procurement, Subsidies and Countervailing Duties, Anti-dumping Duties, Customs Valuation, Import Licensing Procedures and Trade in Civil Aircraft, together with the Arrangement Regarding Bovine Meat and the International Dairy Arrangement. For technical reasons to do with the difficulty of amending the text of

the GATT these agreements are in the form of separate agreements more or less closely linked to particular provisions of the GATT. Each is under the management of a Committee of Signatories, which has the power to amend its Agreement. Developing countries have, by and large, been reluctant to accede to these agreements in spite of considerable efforts to incorporate attractive treatment for them. Therefore the development of obligations in these agreements is effectively under the control of the Committees of Signatories in which developing countries are less influential than they are in the GATT as a whole. We wish to prevent the Ministerial Meeting interfering too much in relation to topics covered by these agreements; otherwise non-signatory developing countries will get the advantage of being able to control the development of the GATT on these points without undertaking the corresponding obligations. To avoid the Ministerial Meeting becoming the occasion for developing country pressure on the Committees of Signatories, efforts are being made in the various Committees of Signatories to develop some generally acceptable propositions in relation to their subject matter which Ministers can be asked to endorse. So far these efforts range from proposals to amend the text of one Agreement (Customs Valuation), to cover certain developments since its inception, to preparation of detailed reviews of the work of Committees of Signatories which Ministers could be invited to note with satisfaction. It seems essential to maintain the general developed country policy of encouraging more developing countries to accede to the various agreements, although particular caution will be needed in relation to the Government Procurement Agreement, as in this case accession of more developing countries may lead, in time, to greater competition in our domestic markets without, in practice, corresponding opportunities for our own exporters.

Agriculture

15 Agriculture will be a major topic in the framework of the Ministerial Meeting. Relatively little progress on agricultural questions was made in the Tokyo Round, and indignation against the CAP among traditional agricultural exporters such as Argentina, Australia and New Zealand has not diminished, and in the United States has strengthened. This reflects increased domestic agricultural problems and concern

at growing surpluses in the Community will damage prospects for them on world markets. The EC will therefore inevitably be on the defensive. A row over agriculture at the GATT Ministerial Meeting would not contribute to a constructive outcome on other aspects of the discussions.

16 Our best approach is to play a quiet role over the coming months while getting ourselves into the position to contribute, if possible, towards finding some accommodation between the interests of the Community and those of third countries. We have domestic interests which will have to be weighed (eg on exports of processed foodstuffs) though anything the Community as a whole may be ready to accept is unlikely to prejudice us. At this stage the most promising prospect seems to be the establishment of an Agriculture Committee in the GATT. This could have the advantage of providing a formal forum in the GATT where agricultural problems can be discussed. There has been such a forum in the past but not in recent years and its establishment would support the Community position that there are some specific problems and issues to be addressed in agriculture against the position advocated, for instance, by the Australians, that the rules of trade for agriculture should be switched without more ado to those that govern industrial products.

Developing Countries

17 Trade with developing countries throws up two main pressures in relation to the Ministerial Meeting. Developing countries are continuing their traditional pressure for import concessions by developed countries on tropical products (mostly agricultural) and continue to press their full range of grievances against the developed world. On the other hand, the developed countries are keen that newly industrialising countries (NICs) should benefit less from the special status conceded in the GATT to poor developing countries and as their economies strengthen should increasingly be prepared to subject their trade to the regime generally adopted by developed countries. This approach has been labelled "graduation" and has as a matter of principle been resisted by developing countries collectively. The main progress made by developed countries in recent years in persuading NICs to liberalise has been through the exercise of strong bilateral pressure, as by the Americans on the Brazilians. A public multilateral meeting such as the GATT Ministerial Meeting can exert pressure on NICs

ly if sensibly handled, although there is strong pressure on some developed country governments such as our own and the Americans, to be seen to be doing something about the NICs, which are seen by domestic industry in some sectors as major threats.

18 Various approaches are under consideration and may be considered further in the OECD before the GATT Ministerial Meeting. The Secretary-General of the OECD has suggested a new instrument in the GATT, involving commitments by developed countries not to misuse safeguards, to promote structural adjustment, and in return, trade reforms by the NICs which would involve them giving up some at least of the privileges associated with developing country status, the attractions of which will be such that NICs will accede to it even though this involves partly giving up their status as developing countries. Without much subtlety, the Americans proposed publicly (at the OECD Ministerial Meeting on 10/11 May) a GATT negotiating round, in which developed countries would offer concessions to developing countries (on products that would otherwise be forced out of generalised schemes of preference) in exchange for better developed country access to NIC markets. The Community is adopting a cautious approach to this last idea. So far our own thinking has been more limited and, we hope more realistic. We are considering a weighty intergovernmental study in the GATT of trade barriers against the exports from developing countries. The idea would be to ensure that this study covered not only developed countries but the more important NICs, so that attention would be paid not so much to the way NICs barriers affect developed country exports, but the way that NICs barriers impede the exports of poorer developing countries. We have not so far launched this idea within the Community but if the ideas coming from the Americans and the OECD Secretariat turn out unrealistic, its moment may come. At the same time, if the American ideas make headway we should work with them while seeking to make them more realistic, and our idea of a study might pave the way for the US ideas.

19 On tropical products, the EC's import regime already compares favourably with those of other developed countries, and the scope for further liberalisation is limited. But the UK ought to be able to contemplate further movement in this area with greater equanimity than some of our partners. Officials are examining the possibilities in detail. UK advocacy of a modest gesture on tropical products should give a boost to our standing with developing countries even if the practical effects are marginal.

Tariffs

20 Tariffs are not expected to figure to a large extent. The cuts agreed in the Tokyo Round are phased and will not be completed until 1987. The Ministerial Meeting may be asked to note the complicated technical negotiations that will be needed in GATT following the expected adoption of a new Harmonised System of tariff nomenclature. The wider implications of this for the UK are being studied, and will be reported to Ministers, separately.

American Priorities

21 It is striking how different from recent GATT priorities the American priority list for the GATT Ministerial Meeting is. The US priorities, announced as far back as last autumn, in addition to agriculture, are trade in services, trade-related investment issues and trade in high technology products. In addition we have some interest in a secondary American objective, counterfeiting. These points are dealt with below.

Services

22 Political pressure on the US Administration to make progress in the Framework of the GATT Ministerial Meeting on trade in services is strong. The Americans now accept privately that the most they can hope for this year is a commitment for the GATT to launch a substantial study programme. So far they have converted the Germans and the Japanese to this approach and we are also sympathetic to it, although we feel that the speed with which the Americans are taking service issues from the OECD to the GATT is ill-judged, given the more protective approach of developing countries. Many developing countries do not see trade in services as a priority for the GATT, and at the international level UNCTAD probably has a better juridical claim to the topic. The Community is prepared to agree to the launch by the Ministerial Meeting of preliminary work for negotiations on trade in services in the GATT, but the fundamental views of the various Member States are divergent. Our interest here is to be seen as sympathetic to the American approach while ensuring that the price which will have to be paid to developing countries to get the issue on to the GATT Agenda is paid primarily by the US.

Investment Issues

23 The Americans worry that intervention by governments in inter-

regional direct investment and incentives for it, linked with performance requirements on such matters are minimum local content and export levels, significantly distort the flows of both investment and trade and tend to undermine the benefits of trade liberalisation.

24 Work on investment is already under way in OECD, the IMF/World Bank and the United Nations. The OECD instruments are the Code of Liberalisation of Capital Movements and the Declaration on International Investment and Multinational Enterprises. Arising from work on investment in developing countries the World Bank, under heavy US pressure, has been considering the impact of incentives and performance requirements on investment and trade decisions on a narrow sectoral basis. In the UN there have been negotiations since 1977 (under developing country - Soviet Bloc pressure) for a code of conduct on transnational corporations: transfer pricing and other issues are under discussion in UNCTAD and there seems little useful purpose to be served in bringing them into the GATT.

25 However the Americans seem over-ready to assume that regional problems they have with Canada and Mexico reflect distortions at the global level and have ideas of developing a "GATT for investment" which we regard as over-ambitious and in some respects potentially harmful to UK interests. UK industrial policy lays considerable stress on the value of inward investment. Although there are superficial attractions in action to restrain international competitive bidding through incentives, the introduction of new rules could leave us worse off in terms of our ability to attract investment, particularly as such restrictions would be likely to bite harder on the UK, with its relatively open and centralised system of incentives, than on others. Trade related performance requirements have not been a prominent feature of our incentive arrangements but there has been some increase in their use - Nissan is a prominent current example. Even if these could be treated in isolation (which is not likely), we would need to think carefully before agreeing to measures which would limit our freedom of action for what could be very uncertain benefits.

26 Bilateral agreements on investment in which LDCs are often prepared to be more forthcoming than in public negotiations at the UN, offer a better approach to the problem of fair treatment. But there is a risk that the US initiative could undermine useful results already emerging from such agreements.

27 Bringing investment issues into the GATT on a broad front is strongly resisted by developing countries and, for obvious reasons, by the Canadians. Given this, it may be that neither we nor the Community need to take a prominent position in opposing the American ideas; our objective should be to limit GATT involvement in investment issues to investigation of specific complaints on infringement of GATT provisions. A US complaint of this type against Canada is already being processed in the GATT machinery.

High Technology

28 Alleged problems distinctive to trade in high technology products have been a high priority for the Americans for many months. But they have been very slow to define what they mean. Recently they have suggested that because of the unique characteristics of trade in high technology products, distortions of trade may exist in areas not so far considered by GATT, such as "industry targetting" and Government-financed R & D. They also consider that these problems may not be satisfactorily addressed where they fall under existing GATT agreements such as the Government Procurement Agreement and the Agreement on Technical Barriers to Trade. They propose a work programme to examine the problems, barriers and disincentives to see how they are tackled under existing GATT agreements, and whether revisions or new agreements are needed to deal with the unique problems of this sector, and so on. It is premature to take a final position until we have a clearer view of what the Americans' underlying concerns are, but we can take the line that they have not yet established that there are problems unique to the high technology sector sufficient to justify such an elaborate programme. The US approach is certainly not one that will commend itself to developing countries.

Counterfeiting

29 Since about 1978 the Americans have been trying to get a GATT agreement on measures to combat commercial counterfeiting. The Community has in principle supported this idea, but has considerable administrative difficulties reflecting the varying roles of Customs and judicial authorities in the different Member States. The Americans are pressing for there to be an agreement in the GATT in time to be endorsed by Ministers in November. This is likely to cause difficulty with developing countries who are not keen on the subject and argue that it is properly the preserve of the World Intellectual Property Organisation (WIPO). Domestically a GATT agreement on counterfeiting would be welcome

to industrial interests though they are under no illusion that the type of text likely to be agreed will lead to a major improvement in anti-counterfeiting measures in other countries. If the Americans can get an agreement negotiated this year we should support this, but should be careful to avoid paying a significant price to developing countries for their acquiescence.

Conclusions

30 This conspectus of the specific issues illustrates that agreement on specific decisions by Ministers and a work programme for the future in the GATT will not be easy. So our objective within the Community should be to steer it in ways that are helpful both to the UK's own objectives and enable it to make a constructive contribution in Geneva.

14 June 1982

MFJ

Trade

10 June 1982

I enclose a copy of a letter from Lord Weinstock to the Prime Minister dated 9 June about the export credit consensus negotiations. We have acknowledged this letter.

B/P
I should be grateful if you would let me have a draft reply that the Prime Minister could send to Lord Weinstock by Monday 21 June.

I am sending a copy of this letter and attachment to Brian Fall (Foreign and Commonwealth Office) and John Rhodes (Department of Trade).

MS

John Kerr Esq
HM Treasury.

10

MFJ

10 June 1982

I am writing to thank you on the Prime Minister's behalf for your letter of 9 June about the export credit consensus negotiations, which I will place before the Prime Minister.

A reply will be sent to you as soon as possible.

MS

The Lord Weinstock

THE GENERAL ELECTRIC COMPANY LIMITED
1 STANHOPE GATE · LONDON W1A 1EH
01-493 8484

cc JV

9th June, 1982

Prime Minister ⁽²⁾

We will let you have
a draft reply as soon as
possible.

Dear Margaret,

Thank you for your letter of 26th May, 1982,
about the export credit consensus negotiations, and for
finding the time to look into the matter when even more
pressing matters call for your constant attention.

Mes 10/6

We have heard of ECGD's efforts to reach
agreement with the Japanese about obtaining access to
yen finance. But our firm impression is that the
amount likely to be forthcoming from the Japanese will
fall far short of what is required to finance the
projects which will come forward from all the OECD
countries; we believe the Japanese are really offering
little more than a sop to sweeten the negotiations.

In practice, we will for most projects be
facing a yen financial package with interest rates
markedly lower than we can offer in sterling or dollars.
The inevitable result will be that the Japanese will
win more and more such business.

/.....

To raise the consensus interest rates further simply in order to preserve the consensus involves potentially real and substantial difficulties to deal with what might well be a short-term American problem, arising, moreover, out of their own domestic economic policies. The rates of interest we are offering even now under the consensus are historically high, and no one knows to what extent they are going to be subsidised over, say, an eight to fifteen years repayment period.

Can I suggest that the right course is to see for a bit longer what effect the existing consensus rates will have on business before deciding to increase them. To postpone a decision for twelve months would enable us to do this and also to see whether the American problem will diminish anyway. I believe almost everybody involved in trying to win large project business overseas would go along with such a policy, and I am sure that it would commend itself to most, if not all, of our EEC partners.

Yours sincerely,

Arnold

Lord Weinstock

The Rt. Hon. Mrs. Margaret Thatcher, MP.,
10, Downing Street,
LONDON, S.W.1.



From the
Minister for Trade

*Top Copy Filed
Economic Policy,
Versailles Summit, pt 7*

DEPARTMENT OF TRADE
1 VICTORIA STREET
LONDON SW1H 0ET

TELEPHONE DIRECT LINE 01 215 5144
SWITCHBOARD 01 215 7877

Five Minutes

To note.

A J Cole Esq
Private Secretary
10 Downing Street
London SW1

A.J.C. 1/6 1 June 1982

Dear John,

VERSAILLES ECONOMIC SUMMIT

At the Prime Minister's meeting on 27 May, the Minister for Trade mentioned counterfeiting as one of the issues on which we would like to see progress made in the GATT.

Counterfeiting is the practice of affixing false or similar trade marks to commercial products or of copying designs or models without authority. In recent years counterfeiting has become a growing problem and imitations of British goods have appeared on the market in the UK and other countries, damaging the business of the manufacturers of the genuine product. Examples of products counterfeited include chemicals, drugs, electronic equipment, motor vehicle and aircraft spares and textiles. Far Eastern countries, notably Taiwan, are prominent among sources of counterfeit goods. HMG advises UK companies to protect their own trade mark and design rights under international intellectual property law and to seek redress in local courts as necessary. Where companies are unsuccessful in obtaining redress we have made representations on a government to government basis.

A draft Agreement on measures to discourage the importation of counterfeit goods was introduced by the United States late in the Tokyo Round of the GATT Multilateral Trade Negotiations but it was not concluded. Since the end of the Tokyo Round in 1979, US and EC negotiators have continued to work on developing a draft Agreement in order to gain a wider measure of support for its introduction. It seems clear, however, that many developing countries regard counterfeiting as a problem which they will not need to tackle for a very long time, if ever, and see resistance to the proposed Agreement as a useful bargaining counter.



The US is currently circulating a revised paper in Geneva which we have yet to study. We would welcome the conclusion of an Agreement in time for endorsement at the GATT Ministerial Meeting in November, provided the price for developing country cooperation is not too high. Failing that, we should support its inclusion in the post-Ministerial Meeting work programme of the GATT.

If appropriate, the Prime Minister could say: "Counterfeiting is damaging and expensive. It can also be dangerous. A GATT agreement would be a useful counter-measure. We hope progress can be made at Geneva."

Mr Rees also promised the Prime Minister an up to date note on the URSUS tractor project. This is attached.

I am copying this letter to Francis Richards (FCO), Peter Jenkins (Treasury), Jonathan Spencer (Industry) and David Wright (Cabinet Office).

Yours ever,

Nicholas McInnes

N McINNES
Private Secretary to the
Minister for Trade (PETER REES)



POLAND: THE URSUS TRACTOR PROJECT

The URSUS project involves the construction of facilities centred on Warsaw for the production of Massey-Ferguson-Perkins (MFP) type tractors and engines. Begun in 1974 and due for completion, in 1980/81 the project has been partly financed by three ECGD guaranteed lines of credit, two in sterling and the third in US dollars, with a total value of some £275m. By the end of 1981 some £140m had been drawn of which £21m had been repaid.

The project has been running about 4 years late and the Poles have now rescheduled it for completion in 1988. On 12 November 1981 Ministers instructed that of the £135m undrawn from the loans already in place a further £30m might be used in 1982. Signature of the necessary agreements was however prevented by the imposition of martial law on 13 December and release of the £30m was placed in abeyance following the meeting of the North Atlantic Council on 3 February.

Subsequently, in order to safeguard the interests of MFP in accordance with its contractual obligations and consistently with the then Lord Privy Seal's parliamentary statement of 5 February 1982 Ministers agreed on 11 February to release £6.8m which remained in an existing sterling line of credit.

This decision, which implied that a good proportion of the £6.8m would go to MFP as payment of fees for services provided, was met with opposition from the Polish authorities, which wished to use most of this credit to buy new capital equipment. Agreement was eventually reached on 30 April although the Poles are still applying pressure to MFP (by refusing to sign the qualifying certificate which would enable them to receive their fees) in the hope of obtaining unrestricted use of the balance (ca £3.8m) which would be left. It has been made clear to the Poles that this money can only be used for existing contracts.

Department of Trade

OT4/1

28 May 1982



OVERSEAS DEVELOPMENT ADMINISTRATION
ELAND HOUSE
STAG PLACE LONDON SW1E 5DH

Telephone 01-213 5409

Trade

From the Minister

N. S. P. R.

27 May 1982

Dear David,

MR 29/5

RAIL WAGONS FOR KENYA

Thank you for your letter of 26 May, in which you asked if it would be possible to reach a conclusion before Tuesday, 1 June, on the request for ATP support to help secure an order for freight wagons from Kenya.

I am afraid that it is not possible, for several reasons, to provide a final answer by that date. In the first place, the developmental case for this supply of wagons is still under consideration here in ODA and by our Development Division in Nairobi. Further information has had to be sought from Nairobi on some aspects and it may be some few weeks yet before a final conclusion can be reached. I understand that the DOT are in fact also awaiting revised costings from BRE-Metro, which were requested all of two months ago, and without these it is clearly not possible to conclude our investigations.

I would not wish you to think that this matter was being looked at with any lack of urgency. However, there has in the recent past been criticism in Parliamentary and other circles about our ATP operations in terms of their developmental justification and I have no option but to ensure that there is an acceptable case on developmental grounds for approving ATP support. The arrangements which have been set up for dealing with ATP applications among the Departments principally concerned are designed to ensure that this aspect as well as the trade and industrial arguments, including employment considerations, are adequately dealt with.

It is also of considerable importance to note that BR is not the only British competitor for this order. A private sector group (comprising Standard Wagons of Heywood and W H Davies of Mansfield) is also actively in the hunt and, on the basis of our latest information, may be more price competitive than BR. In the normal course of events, any ATP offer we made to the Kenyans would be conditional only upon the order being placed with a British contractor. It would therefore apply equally to both bidders in this case, if both were still in the field.

/It is

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It is open to us - the initiative on this rests with the Departments of Trade and Industry - to back a single British competitor and such a decision would be possible in this case. But in so doing, we would need to recognise the potential difficulties for us in giving preference to a public sector organisation over one from the private sector.

Finally, we have to bear in mind that there can be no guarantee that an ATP offer from us would secure the contract for Britain. We and BR both know that a number of other countries are fighting very hard to break into the Kenya market and there are likely to be other very attractive overt and covert offers available to the Kenyan authorities. In other words, the existence of an ATP offer does not guarantee that a contract will necessarily be secured. I cannot see that it would be in their or our interest for their relations with their unions to be soured by the holding out now of what events might prove to be a false promise.

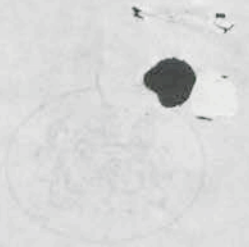
For all these reasons, I hope you can appreciate why we do not think it would be helpful for BR to pin all their faith on this case in their negotiations with the unions. I am copying this letter to the recipients of yours.

Yours,
Neil

NEIL MARTEN

The Rt Hon David Howell MP
Secretary of State for Transport

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27 MAY 1982

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CF. No Trade Up
e. Hunt
DI Trade

10 DOWNING STREET

THE PRIME MINISTER

26 May, 1982.

Dear Arnold,

Thank you for your letter of 12 May.

I readily appreciate your concern about the press reports of the compromise proposals for changing the international Consensus and about the risks to UK export competitiveness as a result of the acceptance of the proposal which will allow the Japanese to offer below Consensus rate finance.

I can assure you that throughout last year's negotiations (which resulted in an interim agreement being reached last October) and in the current round, one of the Government's major concerns has been the need to protect the UK's competitive position. At the same time the UK, both individually and as a member of the European Community, has been conscious of the risks of a breakdown of the Consensus unless agreement is reached on a realignment of interest rates to bring them closer into line with market rates, and the need to strengthen control over the terms of credit offers.

The agreement reached in October was a compromise which participants were finally able to accept and which removed the immediate risk of a breakdown of the Consensus. Failure to achieve any agreement would have had the most serious consequences for the UK's trading position and would have resulted in a damaging and costly credit race between major trading nations. In agreeing to a concession for low interest rate countries the Japanese gave assurances that overseas competitors would have access to Japanese yen to match offers by Japanese exporters for third country trade.

/Access to the

Access to the domestic yen market could of course offer the market depth which is not available in the euro-yen market. In the past few months officials of ECGD and the Treasury have had extensive discussions with the Japanese Government departments concerned and with Japanese banks in London and in Tokyo to establish the basis for a yen financing scheme. Considerable progress has been made in these discussions and you may have seen the reports of a statement made by the Japanese Government at the end of last week about the success which has been achieved so far.

The European Community and all other participants are still considering their attitude to further possible changes to the Consensus, and no final decisions were taken at the Council Meeting on Monday to which you referred. There is however no doubt that all participants are mindful of the need to safeguard export competitiveness and to maintain, and to strengthen, discipline over credit terms.

Finally, you refer to the possibility of reaching an agreement on a European Consensus along the present lines to inhibit damaging competition with our European partners. The risk of dama-
ging intra-Community competition is one of particular concern, especially in those cases where a member state offers a combination of aid and commercial credit in order to provide a package on particularly 'soft' terms. This practice has been growing in recent years, and the interim agreement reached in October was a step in the direction of ensuring greater transparency over the terms of such offers. It is doubtful however whether a European Community Consensus would provide the answer. Under a purely European Consensus export subsidies are unlikely any longer to be permissible under the GATT or the EC Treaty. So the attempt to negotiate such a Consensus could easily backfire, especially as it would leave Japan free to lend at their market rates which are lower than the rates at which they can provide officially supported finance under the current Consensus arrangements.

/I believe the

I believe the best hope of finding solutions to these problems is to maintain and to strengthen the international Consensus. This will not be easy. Failure could give low interest rate countries an even greater advantage whilst simultaneously initiating a very costly export credit race.

Yours sincerely
Raymond White

The Lord Weinstock.



Letter in PM's Box

Trade

Treasury Chambers, Parliament Street, SW1P 3AG
01-233 3000

20 May 1982

Michael Scholar, Esq.,
No.10 Downing Street

Dear Michael

EXPORT CREDIT : LETTER FROM LORD WEINSTOCK

In your letter of 13th May you asked for a draft reply for the Prime Minister to send to Lord Weinstock in response to his letter of 12th May.

.....
We agreed that it would be best to wait until after the meeting of EC Finance Ministers last Monday on this subject before putting forward a reply. As you are aware, no decisions were reached then on the compromise proposals put forward by the Export Credit Group Chairman in Paris twelve days ago. The draft reply for this reason gives no commitment as to the UK's or the Community's attitude to the proposals or what may eventually be agreed. It has been cleared with ECGD at official level.

A copy of this letter goes to John Rhodes at DOT.

Yours ever
Peter

P.S. JENKINS

M type
DRAFT LETTER FROM PRIME MINISTER
TO LORD WEINSTOCK

res 29/5

EXPORT CREDIT CONSENSUS

Thank you for your letter of 12 May.

2. I ~~can~~ readily appreciate your concern about the press reports of the ~~Swedish~~ compromise proposals for changing the international Consensus and about the risks to UK export competitiveness as a result of the acceptance of the proposal which will allow the Japanese to offer below Consensus rate finance.

3. I can assure you that throughout last year's negotiations (which resulted in an interim agreement being reached last October) and in the current round, one of the Government's major concerns has been the need to protect the UK's competitive position. At the same time the UK, both individually and as a member of the European Community, has been conscious of the risks of a breakdown of the Consensus unless agreement is reached on a realignment of interest rates to bring them closer into line with market rates, and ^{the need} to strengthen control over the terms of credit offers.

4. The agreement reached in October was a compromise which participants were finally able to accept and which removed the immediate risk of a breakdown of the Consensus. Failure to achieve any agreement would have had the most serious consequences for the UK's trading position and would have resulted in a damaging and costly credit race between major trading nations. In agreeing to a concession for low interest rate countries the Japanese gave assurances that overseas competitors would have access to Japanese yen to match offers by Japanese exporters for third country

trade. Access to the domestic yen market could of course offer the market depth which is not available in the euro-yen market. In the past few months officials of ECGD and the Treasury have had extensive discussions with the Japanese Government departments concerned and with Japanese banks in London and in Tokyo to establish the basis for a yen financing scheme. Considerable progress has been made in these discussions and you may have seen the reports of a statement made by the Japanese Government at the end of last week about the success which has been achieved so far.

5. The European Community and all other participants are still considering their attitude to further possible changes to the Consensus, and no final decisions were taken at the Council Meeting on Monday to which you referred. There is however no doubt that all participants are mindful of the need to safeguard export competitiveness and to maintain, and to strengthen, discipline over credit terms.

6. Finally, you refer to the possibility of reaching an agreement on a European Consensus along the present lines to inhibit damaging competition with our European partners. The risk of damaging intra-Community competition is one of particular concern, especially in those cases where a member state offers a combination of aid and commercial credit in order to provide a package on particularly 'soft' terms. This practice has been growing in recent years, and the interim agreement reached in October was a step in the direction of ensuring greater transparency over the terms of such offers. It is doubtful however whether a European Community Consensus would provide the answer. Under a purely European Consensus export subsidies are unlikely any longer to be permissible under the GATT or the EC Treaty. So the attempt to negotiate such a Consensus could easily backfire, especially as it would leave Japan

free to lend at their market rates which are lower than the rates at which they can provide officially supported finance under the current Consensus arrangements.

7. I believe the best hope of finding solutions to these problems is to maintain and to strengthen the international Consensus. This will not be easy. Failure could give low interest rate countries an even greater advantage whilst simultaneously initiating a very costly export credit race.

20 MAY 1962





file

BC
Trade

10 DOWNING STREET

From the Private Secretary

13 May 1982

EXPORT CREDITS: LETTER FROM LORD WEINSTOCK

I attach a copy of a letter from Lord Weinstock about which I spoke to you earlier this afternoon.

B/F | I would be grateful for a draft reply for the Prime Minister's signature as soon as possible. Perhaps you would be kind enough to let me know in the course of tomorrow whether you think it would be advantageous to put a draft reply in the Prime Minister's box tomorrow evening; or whether we can reasonably answer in slower time.

I am sending a copy of this letter to John Rhodes (Department of Trade).

Peter Jenkins, Esq.,
HM Treasury

A



file

BK

10 DOWNING STREET

From the Private Secretary

13 May 1982

I am writing on behalf of the Prime Minister to thank you for your letter of 12 May about the Swedish "compromise" on export credit interest rates, for discussion by EEC Ministers next Monday.

A reply will be sent to you as soon as possible.

M. C. SCHOLAR

The Lord Weinstock

THE GENERAL ELECTRIC COMPANY LIMITED

1 STANHOPE GATE · LONDON W1A 1EH

01-493 8484

12th May, 1982

Dear Prime Minister,

I hesitate to worry you at this most difficult time, but I feel I must draw your attention to a development which could do great damage to the GEC and indeed all other British exporters of capital goods. This is the proposed Swedish "compromise" to raise export credit interest rates, which I understand is to be discussed by EEC Ministers next Monday.

The Swedish proposal is that the Japanese rate for Yen finance should go down to something like 8.7 per cent with other interest rates for category I and category II countries going up, together with a number of countries being reclassified upwards to category I or II, as appropriate. The effect of all this is set out succinctly in the attached table. As you can see, this will mean that in many of our most important markets, the Japanese will have an advantage over us of something between 2.3 and 3.8 percentage points, with a corresponding reduction in our ability to compete effectively on major project business requiring substantial financial support.

/.....

I am aware of the proposed new facility for Yen financing to enable the UK manufacturer to finance his project in the same currency at the same interest rate as the Japanese competitor, but unless the Yen becomes as international a currency as, say, the US Dollar, it is most unlikely that Yen finance will be available in the quantity required to enable the UK manufacturer (and indeed other consensus members) to quote in Yen for major project business. Furthermore, if negotiations for Yen financing are not concluded in good time for each specific contract, there is a danger that this facility may indeed become available but only after the contract has been awarded to a (dare I say Japanese?) competitor. As these arrangements are, in any event, in an embryo stage, it is far too soon to know if they could prove advantageous to us. It is also too early to assess the impact on our export business of the October, 1981 increase in consensus rates, because many of our projects continued to be financed under the pre-October rate until quite recently.

I do not think it necessary to underline to you the problems that this proposed variation between UK and Japanese consensus rates could cause in terms of further unemployment. Surely, our right course is to resist any further changes until the present rates have been fully tested. If the result of standing firm on the present arrangements is to make it impossible to arrive at an international consensus, then I believe

/.....

that will be a less damaging result for the UK than agreeing to the Swedish proposal, or anything like it. It ought, however, to be possible to reach an agreement within the Community to a European consensus along present lines which would inhibit damaging competition with our European partners.

I am sorry to have to worry you with yet another issue, but the long term repercussions of what is proposed really do require the most careful assessment before decisions are taken on our negotiating position.

Yours sincerely,

Arnold Weinstock

Lord Weinstock

The Rt. Hon. Mrs. Margaret Thatcher, MP.,
10, Downing Street,
LONDON, S.W.1.

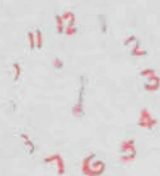
RECLASSIFICATION AND INTEREST RATE CHANGES

EXAMPLES

	Pre-Nov.81	Current	Compromise	% over Japanese rate (probably 8.7%) if compromise accepted
<u>Category I</u>				
U.S.A.	8.5%-8.75%	11%-11.25%	12.25%-12.5%)
(Spain))
(Bahrain))
* (U.S.S.R.) reclassified	8.0%-8.5%	10.5%-11%	12.25%-12.5%) 3.55%-3.8%
(G.D.R.))
(Czechoslovakia))
<u>Category II</u>				
Hong Kong	8.0%-8.5%	10.5%-11%	11%-11.6%)
(Brazil))
(Malaysia))
(Nigeria))
(Mexico))
(Taiwan))
(Paraguay))
* (Peru) reclassified	7.5%-7.75%	10%	11%-11.6%) 2.3%-2.9%
(Algeria))
(Chile))
(Colombia))
(Korea))
(Morocco))
(Tunisia))
<u>Category III</u>				
	7.5%-7.75%	10%	10%	1.3%

* other important markets may also be reclassified

13 MAY 1982



FOEC 031/29

OO UKREP BRUSSELS

GRS 596

CONFIDENTIAL

DESKBY 292130Z

FM FCO 291825Z MAR 82

TO IMMEDIATE WASHINGTON

TELEGRAM NUMBER 598 OF 29 MARCH

INFO IMMEDIATE LAGOS, JEDDA, UKREP BRUSSELS
PRIORITY PARIS, BONN, UKDEL OEGD, ROME, MEXICO
CITY, TEHRAN, BAGHDAD, CARACAS, DOHA, JAKARTA,
DHABI, DUBAI, ALGIERS.

INFO SAVING QUITO, LIBREVILLE, MUSCAT

IMMEDIATE

Trade
BONNE / E-DAUKES /
BENDER / HEALY /

+ 10.

Full Distribution
Selective Distribution:—
Agriculture
Econ/Finance
Ext Trade/Dev Countries
Pol Inst & Legal
Industry, Trans, And Env.
S.A./Lab & R Policy

OPEC

1. YOU WILL HAVE SEEN PRESS REPORTS OF ARAB/OPEC ALLEGATIONS THAT OIL COMPANIES ARE UNDER-LIFTING IN NIGERIA IN ORDER TO PUT PRESSURE ON A VULNERABLE OPEC MEMBER AND SO BREAK THE VIENNA OPEC PRICE AGREEMENT. ACCORDING TO THESE REPORTS THE COMPANIES ARE BEING THREATENED WITH DENIAL OF DIRECT OR INDIRECT SUPPLY BY ARAB OPEC MEMBERS (AND POSSIBLY BY OPEC MORE GENERALLY).
2. NO OIL COMPANY IN LONDON HAS BEEN PREPARED TO ACKNOWLEDGE TO THE DEPARTMENT OF ENERGY THAT THEY HAVE RECEIVED A DIRECT THREAT BUT SHELL AND BP HAVE SAID THAT THEY HAVE RECEIVED INDIRECT MESSAGES. IN BOTH CASES, THESE EMANATED FROM KUWAIT, IN THE CASE OF BP SPECIFICALLY FROM ALI KHALIFA, THE KUWAITI OIL MINISTER.
3. THE MAJOR SELLER OF NIGERIAN OIL IS THE NIGERIAN NATIONAL PETROLEUM CORPORATION (NNPC) WHICH MAKES ITS OWN MARKETING ARRANGEMENTS. SHELL IS THE FOREIGN OIL COMPANY WITH THE LARGEST LIFTING ENTITLEMENT (EQUITY PLUS PURCHASE). WE BELIEVE THE OTHER MAIN FOREIGN COMPANIES WITH REGULAR ENTITLEMENT TO NIGERIAN OIL ARE GULF, MOBIL, PHILLIPS, TEXACO, AGIP, ELF ASHLAND, AND PANOCEAN. THE MIX OF EQUITY AND CONTRACT OIL IS SIGNIFICANT, SINCE THE COMPANIES' EQUITY ENTITLEMENT IS PROPORTIONATE TO THE VOLUMES SOLD BY THE NNPC. THE CONSEQUENCE IS THAT IF THE NNPC LOSES THIRD PARTY CUSTOMERS, THE VOLUME LIFTED BY THE EQUITY PARTNERS ALSO DECLINES.
4. THE COMPANIES' VULNERABILITY TO ARAB OPEC THREATS IS VARIED. IF THE SAUDIS REALLY ARE A DETERMINED PARTY TO THE THREAT, MOBIL AND TEXACO, AS ARAMCO PARTNERS, MUST BE ACUTELY WORRIED. SHELL LIFTS ONLY ABOUT 26,000 BD IN SAUDI ARABIA AND NOTHING AT PRESENT IN KUWAIT. GULF HAS ONLY A MINIMAL DEPENDENCE ON OPEC OIL. BP HAS NO COMMITMENTS OR ENTITLEMENT IN NIGERIA, SO SHOULD NOT BE AT RISK. (BP HAS REPLIED TO KHALIFA, THROUGH THE INTERMEDIARY, TO THIS EFFECT.)

5. ONLY MOBIL AND GULF ARE KNOWN TO HAVE MADE ANY PUBLIC STATEMENT ON THE THREATS. BOTH HAVE DENIED UNDERLIFTING AND POINTED TO SCHEDULED NEW LIFTINGS. DEPARTMENT OF ENERGY HAVE ASKED THE LONDON OFFICES OF MOBIL, GULF AND TEXACO ABOUT THE PARENT COMPANIES, BUT HAVE BEEN GIVEN NO REPLY YET.
6. SHELL HAVE SENT A MESSAGE TO SHEIKH YAMANI SAYING THERE MUST HAVE BEEN SOME MISUNDERSTANDING SINCE IT HAS RESPECTED ITS NIGERIAN LIFTING COMMITMENTS AND, INDEED, IS CURRENTLY OVERLIFTED.
7. IT IS LIKELY THAT THE MAIN LOSS OF NIGERIAN SALES IS DUE TO THIRD PARTY CUSTOMERS DISENGAGING AT SHORT NOTICE WHEN IT BECAME CLEAR AFTER THE VIENNA MEETING THAT THE NIGERIANS DID NOT INTEND TO REDUCE THEIR PRICES. BUT OUR VIEW IS THAT WHATEVER THE MAJORS MAY CLAIM ABOUT THEIR LIFTINGS UNDER EXISTING CONTRACTS THEIR INTENTION WAS TO DISENGAGE, AT LEAST TO SOME EXTENT, FROM 1 APRIL AS CONTRACTS COME UP FOR RENEWAL.
8. (FOR WASHINGTON) WE SHOULD BE GRATEFUL FOR AN EARLY ACCOUNT OF US THINKING. YOU MAY INFORM US OFFICIALS IN STRICT CONFIDENCE OF PARAS 1-7 ABOVE. IF ASKED YOU SHOULD SAY THAT WE ARE STILL CONSIDERING THE WIDER IMPLICATIONS OF THESE MOVES. (WE HAVE ALSO SPOKEN TO THE US EMBASSY IN LONDON).
9. (FOR OPEC POSTS) YOU SHOULD NOT TAKE THE INITIATIVE IN RAISING THIS WITH OPEC GOVERNMENTS. IN RESPONSE TO ANY ENQUIRIES YOU SHOULD SAY THAT WE HAVE RECEIVED NO OFFICIAL CONFIRMATION OF THESE REPORTS. THIS IS A QUESTION ON WHICH THE OIL COMPANIES ARE BETTER PLACED TO COMMENT THAN US.

CARRINGTON

NNNN

CONFIDENTIAL

PRIME MINISTER

Community Affairs

The Secretary of State for Trade could report on the outcome of the 25th February Textiles Council. The Council resolved the two principal outstanding problems - burden sharing of the global import ceilings, and the outward processing levels within these ceilings - to the satisfaction of the United Kingdom. The Community will therefore now accept the Protocol extending the present Multi-Fibre Arrangement for some 4½ years, subject to withdrawal by the end of 1982 if acceptable bilateral agreements with individual low cost supplying countries have not been concluded by then.

2. An informal meeting of Development Ministers took place on 2nd March but gave rise to no points calling for discussion in the Cabinet.

3. Next week the Research Council will meet on 8th March.

REA

Robert Armstrong

3rd March 1982

CONFIDENTIAL

PRIME MINISTER

*I shall need a
full 'substantial' on the
details of this agreement
re: .*

Trade
cc Mr. Gow
Mr. Coles
Press Office

MFA

I attach the text of Mr. Rees' Statement today.

This was a procedural disaster. The Statement was scheduled for a Friday partly to fulfil undertakings to keep the House rapidly and fully informed of MFA developments, and partly to help with the management of today's Private Members Bills. Preparation of the Statement was always likely to be tight, but in the event Mr. Rees arrived at the House at 10.57, having been unable to provide any sort of advance text to the Opposition or to any of his Ministerial colleagues. His delivery of the Statement was therefore preceded by a formal protest by the Opposition Chief Whip, and a series of Points of Order from the Opposition benches.

Replying from the Opposition front bench, Ken Woolmer said that he could only give off-the-cuff reactions in the circumstances, so that a full debate would be necessary. MFA 3 had to stem the tide of job losses associated with its two predecessors. The major concerns would be on the problem of dominant suppliers, Group 2 and 3 products, and the need for work to be put in hand in consultations with unions and the industry about alternative arrangements should we need to withdraw from the MFA. At this point and later, Mr. Rees made it clear that a debate could be considered, but that he felt it ought to await detailed settlement of the quotas. Nicholas Winterton challenged the basing of the '83 quotas on the '82 figures instead of on the actual level of imports this year. This prevented the linkage of import growth rates with market growth. Bob Cryer followed the same theme. He argued that the 1% growth rate based on the '82 quotas allowed potential effective growth of 23% in sensitive areas. Charles Fletcher-Cooke wanted Mr. Rees to spell out a deadline for withdrawal, whilst James Hill asked about Hong Kong's position. Stan Cohen and James Lamond joined in the concern about low cost imports, although Mr. Lamond recognised

/the

the need to balance producer and consumer interests. This allowed Mr. Rees to underline the problems of balancing the needs of domestic industry, the claims of the Third World, and the problems of our exporters, who could be denied access to markets in other products if we did not tread warily in the textiles field. Winding up, Mr. Woolmer again pressed for a full debate.

Mr. Rees was patient and thorough with the House - perhaps irritating the Speaker slightly, but plainly helping the Chief Whip's problems for the day. But the news he brought from Brussels has done nothing to allay the fears of the textile lobby, and the morning's procedural failures will make it more difficult to resist pressure for a debate if the Opposition continue to demand one.

MR

26 February 1982



DEPARTMENT OF TRADE
1 VICTORIA STREET
LONDON SW1H 0ET

TELEPHONE DIRECT LINE 01 215 5144
SWITCHBOARD 01 215 7877

From the
Minister for Trade

Mike Pattison Esq
Private Secretary
10 Downing Street

26 February 1982

Dear Mike,

MFA STATEMENT

I attach a copy of the statement that my Minister intends to make later this morning about the outcome of the negotiations on the MFA at yesterday's Foreign Affairs Council.

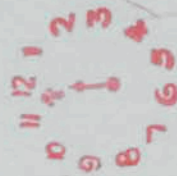
I am copying this letter and the statement to Nick Huxtable (Lord President's Office), Jonathan Spencer (Industry), Stephen Gomersall (FCO), Murdo Maclean (Chief Whip's Office) and to David Wright (Cabinet Office).

Yours ever,

Nick McInnes

N McINNES
Private Secretary to the
Minister for Trade (PETER REES)

26 FEB 1982



DRAFT STATEMENT

HOUSE OF COMMONS: FRIDAY,
26 FEBRUARY, 1100 HRS

1 WITH PERMISSION MR SPEAKER I SHOULD
LIKE TO MAKE A STATEMENT ON THE SPECIAL
FOREIGN AFFAIRS COUNCIL TO
DISCUSS TEXTILES WHICH TOOK
PLACE IN BRUSSELS YESTERDAY.

2 I AM GLAD TO BE ABLE TO

TELL THE HOUSE THAT THE COUNCIL AGREED
THAT THE COMMUNITY

SHOULD SIGN THE EXTENDED MULTI—
FIBRE ARRANGEMENT WHICH WAS
ADOPTED BY THE GATT TEXTILE
COMMITTEE IN GENEVA ON
22 DECEMBER LAST. THE
COUNCIL ALSO AUTHORISED THE
COMMISSION TO START
NEGOTIATIONS IMMEDIATELY ON NEW
MFA BILATERAL AGREEMENTS
WITH SUPPLYING COUNTRIES. THESE

2

SHOULD COME INTO EFFECT
ON 1 JANUARY 1983 WHEN THE
CURRENT AGREEMENTS EXPIRE.

3 THESE NEGOTIATIONS WILL TAKE

PLACE WITHIN A FRAMEWORK OF

REVISED GLOBAL CEILINGS FOR

IMPORTS OF THE EIGHT MOST

SENSITIVE TEXTILE AND CLOTHING

PRODUCTS - THE SO

CALLED GROUP I PRODUCTS. THESE

NEW CEILINGS WILL APPLY TO

3

ALL IMPORTS FROM LOW-COST SOURCES

BOTH FROM OUR MFA PARTNERS AND THE

COMMUNITY'S PREFERENTIAL

SUPPLIERS AND WILL INCLUDE ALL OUTWARD

PROCESSED TRADE. THE CEILINGS

REPRESENT A FIRM

COMMITMENT BY THE COMMUNITY TO

REGULATE IMPORTS IN THESE HIGHLY

SENSITIVE CATEGORIES. THEY TAKE

ACCOUNT OF PLANNED

343A

CUT-BACKS IN IMPORTS WHICH WILL BE
THE SUBJECT OF NEGOTIATIONS WITH THE
COMMUNITY'S DOMINANT SUPPLIERS
TOGETHER WITH OTHER

4

TECHNICAL ADJUSTMENTS AIMED AT
REDUCING THE TOTAL LIABILITY OF
THE COMMUNITY. THE RATE OF GROWTH
WHICH WILL BE ALLOWED ON
THESE QUOTAS WILL BE VERY
SMALL. FOR THE UK THE
OVERALL ^{ANNUAL} GROWTH RATE IN THIS
ESPECIALLY SENSITIVE AREA WILL BE
ROUGHLY ONE PER CENT.

5

4 FURTHERMORE THE COUNCIL AGREED THAT
ANNUAL GROWTH RATES FOR THE LESS SENSITIVE
PRODUCTS OUTSIDE GROUP I SHOULD
ALSO BE KEPT VERY LOW. IN
VIEW OF RECENT TRENDS IN CONSUMPTION
THEY WILL IN GENERAL BE ^{LOWER} ~~LESS~~ GENEROUS
THAN THOSE NEGOTIATED WITH SUPPLYING
COUNTRIES UNDER MFA 2.

5 CONSIDERABLE CONCERN HAS BEEN

6

EXPRESSED TO ME BY HON MEMBERS

AND BY REPRESENTATIVES OF THE INDUSTRY

ABOUT THE POSSIBILITY OF THE PROPOSED

NEW ANTI-SURGE MECHANISM WHICH IS

DESIGNED TO PREVENT TOO RAPID A

^{OF}
TAKE-UP ~~IN~~ UNDER-UTILIZED QUOTAS -

BEING NULLIFIED BY AN

EXCEPTIONAL SURGE OF IMPORTS ~~IN UNDER~~

THE QUOTAS ~~CONCERNED~~ IN THE COURSE

OF 1982. I AM GLAD TO TELL THE HOUSE

7

THAT AT THE INSISTENCE OF THE UK
THE COUNCIL AGREED ON SPECIAL
MEASURES TO COUNTERACT THIS POSSIBILITY.
FIRSTLY, RAPID ANTI-DUMPING OR
~~COUNTERVAILING~~ ACTION WILL BE TAKEN
IN APPROPRIATE CASES. SECONDLY, IN
PARTICULARLY SERIOUS CASES,
ACTION WILL BE TAKEN AS A MATTER
OF URGENCY UNDER THE GENERAL REVIEW

8

CLAUSES IN THE EXISTING

BILATERAL AGREEMENTS SO AS TO REACH

(RELATED TO QUANTITIES

A ~~QUANTITATIVE~~ SOLUTION. THESE

ARE MAJOR INNOVATIONS AND WILL,

I HOPE, HELP TO REASSURE THE

HOUSE ABOUT THIS POTENTIALLY DIFFICULT

PROBLEM.

6 THE COUNCIL ALSO CONSIDERED

THE TREATMENT TO BE GIVEN TO

OUTWARD PROCESSED GOODS.

9

INDUSTRIAL REQUIREMENTS IN THIS
SECTOR VARY WIDELY WITHIN THE
COMMUNITY. SO FAR AS THE UK
IS CONCERNED I AM GLAD THAT
AFTER CONSIDERABLE DISCUSSION
OUR COLLEAGUES IN THE COMMUNITY
WERE ABLE TO MEET

OUR REQUIREMENTS ON THIS

DIFFICULT POINT.

I CAN CONFIRM THAT WE SHALL

BE UNDER NO OBLIGATION TO OPEN

SPECIAL QUOTAS FOR ADDITIONAL

OUTWARD PROCESSED GOODS, WHICH
IS IN ACCORDANCE WITH THE WISHES OF THE
THE UK INDUSTRY WITH WHOM WE HAVE ~~KEP~~
KEPT IN CLOSE TOUCH THROUGHOUT THE
NEGOTIATIONS

THE ONLY EXCEPTION WILL BE ANY
SUCH TRADE OFFERED TO THE DOMINANT
SUPPLIERS AS COMPENSATION FOR THE
CUT-BACKS IN THEIR NORMAL TRADE
WHICH I MENTIONED EARLIER.

7 THE STAGE IS NOW SET,
MR SPEAKER, FOR THE COMMISSION TO
BEGIN THEIR BILATERAL NEGOTIATIONS
WHICH WILL DETERMINE
THE PRECISE QUOTAS FOR EACH
COUNTRY AND EACH PRODUCT.
THE MANDATE GIVEN TO THE
COMMISSION IS A TOUGH ONE, INCLUDING
AS IT DOES POINTS
ESTABLISHED AT EARLIER COUNCILS

WHICH HAVE BEEN REPORTED TO THE HOUSE SUCH

AS GOTO PAGE (12)

INTRODUCTION OF NEW QUOTAS:

~~REDUCES~~
~~REDUCTIONS IN THE USE OF FLEXIBILITY~~

IN THE USE OF SOME QUOTAS; ~~REVISIONS~~

~~FURTHER REDUCTIONS IN FLEXIBILITY~~

A ~~AND~~ COMMITMENT TO CONSULT UNDER

THE GENERAL REVIEW CLAUSES IN THE EVENT

OF RECESSION; TOGETHER WITH THE

CUT-BACKS ON THE

~~SUPPLIERS~~
DOMINANTS AND THE ANTI-SURGE

MECHANISM WHICH I HAVE ALREADY

13

MENTIONED. ALL THIS, MR SPEAKER,
IN ADDITION TO THE
~~WITHIN THE~~ GENERALLY MORE

RESTRICTIVE GLOBAL CEILINGS AND GROWTH
RATES AGREED YESTERDAY.

8 THE COMMISSION IS TO REPORT

BACK TO THE COUNCIL ON PROGRESS MADE IN

THE AUTUMN. UNTIL THEN ~~WE CANNOT BE~~
~~WE CANNOT BE CERTAIN~~
~~PRECISELY WHAT QUOTAS~~
~~CERTAIN HOW SUCCESSFUL THEY~~
~~WILL EMERGE~~

~~WILL BE.~~ HOWEVER, THE COUNCIL

DECIDED YESTERDAY THAT IN THE

14

ABSENCE OF THE SATISFACTORY
RENEWAL, IN GOOD TIME, OF THE
BILATERAL AGREEMENTS THE COMMUNITY
WOULD NOTIFY ITS WITHDRAWAL
FROM THE MULTI FIBRE
ARRANGEMENT ^{BY} ~~AT~~ THE END OF
THIS YEAR. ~~THIS IS A FIRM~~
~~DECISION OF THE COUNCIL AND A~~
~~CLEAR INDICATION OF THE DETERMINATION~~

15

~~OF THE COMMUNITY TO OBTAIN A~~

~~SATISFACTORY OUTCOME.~~

9 AS I THINK I HAVE MADE

CLEAR, MR SPEAKER, YESTERDAY WAS

NOT THE END OF THE

STORY. WE SHALL BE

MONITORING PROGRESS IN THE

NEGOTIATIONS VERY CAREFULLY INDEED

TO ENSURE THAT THE SPECIAL

INTERESTS OF THE UK INDUSTRY

16

ARE KEPT FULLY IN MIND BY THE
COMMISSION. IF THE COMMISSION FULFILLS
ITS MANDATE - AND I HAVE
EVERY CONFIDENCE THAT IT WILL -
I THINK THERE CAN BE NO DOUBT
THAT THE NEW MFA BILATERAL
AGREEMENTS WILL, BY ANY
DEFINITION, BE SIGNIFICANTLY
TOUGHER THAN THOSE CURRENTLY
IN FORCE AND THE ALREADY HIGH DEGREE

OF PROTECTION AFFORDED ^{TO} THE UK

INDUSTRY WILL BE SUBSTANTIALLY

ENHANCED, THUS ENABLING ^{THE} ~~THE~~ INDUSTRY

TO CONTINUE THE PROCESS OF

RESTRUCTURING AND MODERNIZATION

UPON WHICH IT IS ALREADY

EMBARKED.

15



CONFIDENTIAL

Thatcher

P.0666

PRIME MINISTER

United Kingdom Trading Policy and
the Practices of our Competitors.

E(82)10 & 15

BACKGROUND

Flag B /
In E(82)10 the Secretary of State for Trade invites the Committee to consider whether changes are needed in the United Kingdom's trading policy. His paper covers, at Annex I, an inter-departmental study by officials on possible ways in which the UK's trading arrangements could be made to work more to our advantage and, at Annex II, a study by the Department of Trade on how Japan, France, Germany and the United States pursue overseas projects. These two reports were sent to you and to a few other Ministers in December. In his present paper the Secretary of State for Trade takes account of comments on the first report. The CPRS make a number of proposals in their paper E(82)15.

Flag C
2. The Secretary of State for Trade's main propositions are that the national interest lies in the maintenance of the open trading system and that the UK should stay broadly on the present course in attacking other countries' non-tariff barriers rather than in erecting its own. He makes a number of particular recommendations on both exports and imports.

EXPORTS

The Aid Programme

3. In paragraph 3(c) and (d) of E(82)10 the Secretary of State for Trade recommends that, unless there is to be a sharp fall in the amount of overseas projects won, there should be increases in the provision for support of projects under both the Aid and Trade Provision (ATP) and under the Science and Technology Act.

4. In 1982-83 the total aid programme is about £1 billion of which the ATP is £52 million, bilateral aid £600 million and the balance is multi-lateral aid. On the assumption that the Secretary of State is not proposing an increase in

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overall public expenditure provision for the aid programme, he is in effect recommending that the Foreign Secretary should increase the ATP at the expense of bilateral aid. Quite apart from any doubts that Foreign Office Ministers may have on that count, Treasury Ministers may be concerned that a further increase in ATP provision, which is usually used in mixed credit operations, could lead to a mixed credit war in which the United Kingdom could be the loser.

5. If, nevertheless, the Committee wish this proposal to be considered further it could be examined in the annual inter-departmental review, which will begin shortly, of the aid framework. This review will also deal with the question raised in paragraph 5 of the CPRS paper E(82)15 on whether sufficient is being done to get the maximum commercial and industrial benefits for the UK from the aid programme. It would be for the Foreign Secretary to take the lead at Ministerial level and to make recommendations.

6. There is relatively little support for export projects under the powers of the Science and Technology Act and there is probably not much in this suggestion. It would, however, be open to the Secretary of State for Industry to give greater priority within his present public expenditure provision if Treasury Ministers concurred.

Criteria for Support of Large Projects.

7. The CPRS suggest in paragraph 3 of their paper that Ministers might consider asking officials to consider whether the present and prospective gains to the UK from some large projects (which might be supported either through export credit or through the ATP) are worth the costs in terms of aggregate Exchequer support and whether officials might be asked to propose guidelines and assess a sample of projects. Treasury Ministers may well support this proposal. The Secretary of State for Trade will probably be sceptical on the grounds that while past studies have demonstrated that it is undesirable to go too far in subsidising exports it is necessary for the UK to match the practice of overseas competitors unless we are to surrender business to them. He may argue that the present system provides for both officials and Ministers to

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consider very carefully the amount of aid offered to individual large projects so that any general study would not be particularly useful.

8. If the Committee were to decide that a study would be worthwhile it could, as the CPRS suggest, be carried out by the Official Committee on Exports (EX(0)) which is chaired by the Department of Trade.

Sectoral Priorities

9. The CPRS suggest in paragraph 4 of their paper that instead of operating on a first-come, first-served basis the UK, like other Governments, should have clearer priorities to be agreed with the aim of identifying sectors where effort should be concentrated to support technologies where the UK has an established lead, new technologies and potential growth areas. They believe that agreement on such an approach would strengthen the case for increasing the ATP. The Secretary of State for Trade is likely to oppose this strongly. He believes - paragraph 3 of E(82)10 - that support should be 'concentrated on energetically active firms who are either already competitive or close to being so'. He may argue that such firms select themselves by getting into a position where they are already technically competitive and the Government can then finally help them to secure the business by adjustments to the financial package. If the Committee were to reject this argument of natural selection and endorse the recommendation of a study the remit might be given to EX(0).

Export Credits and other Export Support.

10. The Secretary of State for Trade makes a number of comments on export credits in his paragraph 3(a). The Treasury have no objection in principle to making Yen financing available to UK exporters and work on an ECGD scheme is near to completion. The Chief Secretary may prefer to leave open the questions of whether consensus interest rates should be increased and whether in some cases there might be unilateral increases in rates above consensus levels.

11. There is unlikely to be any objection to the proposals for maintaining ECGD's facilities and role (paragraph 3(b)) and support provided through the British Overseas Trade Board and Posts overseas (3(e)).

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Non-Tariff Barriers

12. The Secretary of State for Trade recommends that we should stay broadly on our present course in attacking competitors' non-tariff barriers rather than erecting our own. Specifically he recommends keeping up pressure in a number of detailed ways set out in paragraphs 43 and 44 of the note by Officials at Annex I of E(82)10. There is likely to be broad agreement to this general approach and to the detailed proposals put forward by officials. *Flag A /* The Attorney General has, however, in his minute of 22 February to you warned against endorsement of the recommendation in paragraph 43 (ii) of the report by officials that the Commission should use the Cassis de Dijon judgement to secure unimpeded access through the Community for whatever is legitimately manufactured and marketed in one member state. The Attorney General advises that this is a misunderstanding of the judgement, and that the proposed approach could run counter to the UK's defence of restrictions against imports of UHT milk and cream and of poultry meat. It should not be necessary to go into this point tomorrow and if necessary the Secretary of State for Trade and other Ministers concerned could pursue it with the Attorney General.

13. There is likely to be agreement with the need for the UK to be on guard against French attempts to re-conquer their home market for French industry. *Flag D.* In his minute of 13 January the Minister of Agriculture proposed that, if all else failed, the Government would need on occasions to subsidise UK industries so that they could withstand subsidised competition. The Chancellor of the Exchequer would only be prepared to consider such an option in the most exceptional cases and provided that the subsidies could be found from within agreed public expenditure ceilings.

14. The Secretary of State for Trade further recommends 'keeping up pressure, particularly within the Community, against other countries which are erecting covert restrictions or giving unfair production or export subsidies'. The CPRS question, in paragraph 9 of E(82)15, whether more can be done to maintain generalised pressure and whether, without undermining this, more use can be made selectively of 'appropriate instruments on behalf of our own industrial interest'. Care will be necessary in trying to have the best of both worlds but it might be possible to consider some selective and covert protection in the work which is already in hand on standards and certification (see paragraph 16 below).


CONFIDENTIAL

IMPORTS

15. Those Ministers who commented in earlier correspondence were in agreement with the Secretary of State for Trade's general proposition that the Government should not embark upon a systematic policy of covert protection of UK industry. There are a number of particular points which have to be noted or approved.

Review of standards and certification

16. The Secretary of State for Trade argues against using standards to afford marginal covert protection in some product areas (paragraph 5(i) of E(82)10). As the CPRS point out in paragraph 8 of their paper the primary aim of standards should be to improve the quality of British products. Following discussion in the Chancellor of the Exchequer's Group (MISC 14) Department of Trade officials are already in the lead in an inter-departmental study of ways in which the use of standards could help to improve the performance of UK industry. This study could take on board any particular points made in the Committee's discussion. This review will also report on the scope for using safety regulations. The Secretary of State for Industry has proposed that there should be a wider study of the use of such controls to ensure compliance with other regulations eg to stop the import of radio and telephone equipment which could not be lawfully operated in the UK.

Overt measures

17. There is unlikely to be dissent on the Secretary of State for Trade's proposals for:

(i) Accepting the recommendations in paragraph 42 of the report by officials for a greater degree of Community preference in tendering for European Investment Bank financial projects, but no formal change of policy (paragraph 5(ii) of E(82)10).

(ii) Being ready to use other legitimate instruments available eg GATT Article XIX, anti-dumping action and the multi-fibre arrangement (paragraph 2(iv) of E(82)10).

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18. Officials examined legal procedures for enforcing Community law in the UK and other member states. They concluded that the enforceability of Community law seemed to be less effective in certain other member states than in the United Kingdom but could not recommend any of the more radical devices examined as a means of bringing about the same effect in the United Kingdom. The Lord Chancellor has minuted (Annex III of E(82)10) in support of this recommendation but he has not ruled out that a decision should be taken case by case on whether the Government should seek to secure delay by a reference to the European Court of Justice where this is defensible in Community law (note by Officials, paragraphs 34-37). The Secretary of State for Trade accepts the Lord Chancellor's advice (paragraph 5(iv) of E(82)10), although it is not clear whether he acknowledges that the advice does not preclude references to the European Court in appropriate cases. The Committee may feel that the Lord Chancellor's advice should not, on this point, be interpreted unnecessarily restrictively.

19. The Chancellor of the Exchequer has decided not to pursue a suggestion by the Secretary of State for Industry that the possibility of accelerating VAT on imports should be further explored.

JAPAN

/ 20. Mr Scholar's letter of 9 February reports that you commented on these papers "I still think that we have not begun to tackle the Japanese problem". The Secretary of State for Trade comments on the problems of Japan in paragraph 2(ii) of E(82)10; he has suggested the need for a concerted Government policy towards Japan and has offered a paper after the EC Foreign Affairs Council on 22 February which has postponed substantive discussion of Japan until its March meeting. Sir Robert Armstrong has arranged for a comprehensive report on British policy towards Japan to be submitted to Ministers in good time for the Economic Summit at Versailles on 4-6 June. It might, therefore, be best for the Secretary of State for Trade to put forward his paper for discussion at the same time as the officials' report, clearing his line for the March Council meanwhile through OD(E).

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HANDLING

21. After the Secretary of State for Trade has introduced his paper you will wish to ask Mr Ibbs to speak to the CPRS note. The two papers cover a very wide range of issues and in considering whether there is a case for any modification in the Government's general approach to trade policy you may wish to break down the discussion under the two broad heads of exports and imports. The Committee will wish to hear in particular the comments of the Chief Secretary, the Secretary of State for Industry, the Minister of Agriculture and the Lord Privy Seal.

22. On exports the main questions are:

(i) Should there be a further review of the size of the Aid and Trade Provision within the aid programme and of the commercial benefits flowing from the aid programme? (paragraphs 3-6 above).

(ii) Should EX(0) review, as proposed by the CPRS, the criteria for support of large projects? (paragraphs 7 and 8).

(iii) Should there be a review, as proposed by the CPRS, of sectoral priorities? (paragraph 9).

(iv) Are the proposals in paragraph 3(a), (b) and (e) of E(82)10 on Yen financing, ECGD facilities and export support endorsed? (paragraphs 10 and 11).

(v) Is it agreed that the UK should stay broadly on the present course in attacking competitors' non-tariff barriers rather than in erecting its own? In particular are the recommendations in paragraphs 43 and 44 of the note by officials, at Annex I of E(82)10, agreed subject to the point made by the Attorney General in his minute of 22 February? (paragraph 12).

On imports the questions are:

(vi) Is it agreed that the Government should not embark upon a systematic policy of covert protection of UK industry but that the policy should be a pragmatic one? (paragraph 15).

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(vii) Are there any further points which the Committee wishes to be considered in the present review of standards and certification and of ports controls? (paragraph 16).

(viii) Are the proposals on the European Investment Bank tendering procedures and on readiness to use other legitimate instruments for protection against imports endorsed? (paragraph 17).

(ix) Is the Lord Chancellor's advice against tampering with the procedure of the Courts accepted, while leaving open the possibility of references to the European Court on a case by case basis where this is defensible in Community law? (paragraph 18).

(x) Are the arrangements proposed in paragraph 20 above for dealing with further work on Japan acceptable?

CONCLUSIONS

23. You will wish to record conclusions on the particular questions listed above as the Committee works through the papers. These questions cover the points summarised in the Secretary of State for Trade's own conclusions at the end of E(82)10.

PL

P L GREGSON

24 February 1982

CONFIDENTIAL



CONFIDENTIAL

Prime Minister *cc. AD* (2)
Hes 24/2

ROYAL COURTS OF JUSTICE
LONDON, WC2A 2LL

01-405 7641 Extn 3201

22 February 1982

PRIME MINISTER

UK TRADING POLICY AND THE PRACTICES OF OUR COMPETITORS

I have seen John Biffen's paper (E(82)10). Unless you or colleagues wish it I do not propose to attend the meeting at which this paper is to be taken, but there is one point which I feel I ought to mention. In paragraph 4 of his paper John Biffen endorses inter alia the recommendation in paragraph 43 ii of the report by officials (Annex I to the paper) ("Commission use of the Cassis de Dijon judgment to secure unimpeded access throughout the Community for whatever is legitimately manufactured and marketed in one Member State"). I would make two observations on this.

First, in my opinion the "Cassis" judgment does not establish a requirement for access throughout the Community for whatever is legitimately manufactured and marketed in one Member State. It is only the Commission who have sought to interpret the judgment in that sense. A recent judgment of the European Court suggests that that interpretation is incorrect. I therefore doubt whether the "Cassis" judgment could provide an effective tool were you and colleagues to decide to encourage the Commission to seek such a development in community law.

Second, you and colleagues will wish to consider whether it is generally in our interests to encourage such a development. I would merely recall that it would run counter to the main plank of the defence of our restrictions

/on

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ROYAL COURTS OF JUSTICE
LONDON, WC2A 2LL

01-405 7641 Extn

on the importation of UHT milk and cream - currently before the Court - and to what I imagine will be the defence of our restrictions on imports of poultrymeat - recently the subject of a Commission application to the Court. In the recent case, mentioned above, with a view to protecting our position in the UHT milk case, we argued before the Court that manufacture in accordance with the law of one member state did not of itself preclude import controls on health grounds in another member state - an argument which the Court approved.

I am sending copies of this minute to members of E Committee.

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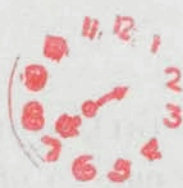
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ROYAL COURT OF JUSTICE

LONDON, GREAT BRITAIN



23 FEB 1982



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bc August

10 DOWNING STREET

From the Private Secretary

9 February 1982

United Kingdom Trading Policy

The Prime Minister was grateful for the Chancellor of the Exchequer's minute of 25 January, whose contents she has noted. She also saw earlier minutes from the Minister of Agriculture of 13 January and from the Secretary of State for Industry of 20 January.

The Prime Minister has commented on these papers:

"I still think that we have not begun to tackle the Japanese problem".

As you will know, this general issue of UK trading policy is for discussion at a meeting of E scheduled to take place later this month.

I am sending copies of this letter to Brian Fall (FCO), John Rhodes (Department of Trade), Jonathan Spencer (Department of Industry), Michael Arthur (Lord Privy Seal's Office), Robert Lowson (MAFF) and David Wright (Cabinet Office).

MCS

John Kerr, Esq.,
H.M. Treasury.

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B

2
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Prime Minister. Trade
This is coming to E
in 18th February.
M
K
4th 2

Trade
No. 100/Barney
Prime Minister

UNITED KINGDOM TRADING POLICY

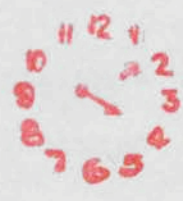
1. I have seen a copy of John Biffen's minute to you of 23 December about UK trading policy and the Note by Officials accompanying it and also copies of Peter Walker's minute of 13 January, Patrick Jenkin's minute of 20 January and Geoffrey Howe's of 25 January.
2. I endorse John Biffen's view that we should not seek covert protection through the erection of additional non-tariff barriers. As Patrick Jenkin points out, there are major disadvantages in any attempt to effect covert protection on a major scale. This can only compromise our objective of eliminating barriers to our own exports in other markets and would do little to help with our own industries' adjustment problems. The report by officials brought out clearly the limited scope for achieving effective protective measures by this means and highlighted the risks involved in possible breach of our GATT and EC obligations. This of course applies equally to overt quota and restraint arrangements. Such measures carry with them an added risk of trade retaliation which experience has shown we cannot afford to ignore.
3. I do not however disagree with the view expressed by colleagues that we should do all we can on a pragmatic basis to make the Community trading system work more to our advantage, notably by continuing to press vigorously for better Community control of national aids to agriculture, by using the standards and certification system on the lines set out in the paper and by making a more determined attempt to removed NTBs in the EC. On this I was interested in Patrick Jenkin's suggestion that we should explore fully the possibility of making progress on the basis of the 'Cassis de Dijon' approach, given the slow pace of the Article 100 programme. I gather officials will be looking further at this. I also agree with him that we must do what we can to stimulate Commission action on the recent French measures aimed at 'reconquering' their internal market: a good start was made at the Foreign Affairs Council on 26 January, when the Commission agreed to produce an urgent report following expressions of concern by several Member States.
4. I have one final point about the reference in John Biffen's minute to the EMS. I agree with him that a competitive exchange rate is important for securing our trade position, but I do not accept that full EMS participation would prevent us from determining our exchange rate. Our partners have been able to adjust their parities within the EMS when necessary.
5. I am sending copies of the minute to recipients of the earlier correspondence.

4 February 1982

A.A.
CONFIDENTIAL



4 FEB 1982



COOPERATIVE

1982

C.A.D.



Prime Minister

(2)

To note at this stage.

The whole issue is for

Treasury Chambers, Parliament Street, SW1P 3AG discussion at a
01-233 3000

meeting of E later this
month.

PRIME MINISTER

MCS 5/2

UNITED KINGDOM TRADING POLICY

I have seen the Secretary of State for Trade's minute to you of 23 December, and the official report accompanying it.

2. I think his assessment of the possibilities of any form of systematic invention or maintenance of non-tariff barriers (NTBs) is about right. In general, I support his conclusion that we should continue to act pragmatically. I do not think the report offers for the most part any new types of useful covert action. But this is scarcely surprising, since we are already well aware of the general possibilities open to us. That conclusion does not of itself tell us a great deal. In practice the actual options matter less than our attitude to specific cases: we must show that we are ready to consider a full range of options and if we decide to act, to act with determination.

3. Our main concern is to combat any notions held at home, or by our competitors, that we are a soft touch. We must ensure that we do not neglect the weapons we have available to attack or put pressure on other countries' non-tariff barriers, or to protect our industries against unacceptable competition here. In the past our approach has been unduly passive. When we see our interests threatened, we must be ready to act swiftly and decisively, to show people that we mean business. That strategy will inevitably mean we run greater risks than hitherto of

/retaliation or of



retaliation or of being declared out of court. But I think that is a price we should be prepared to pay.

4. The counterpart of that is that where we cannot take swift action we must stand ready to put our case to show that that decision has only been taken after full consideration of the options available. The report gives us some pointers - we should draw on them.

5. I do feel we can do more than simply note the points made. Certainly the conclusions on alternative protection for certain industries (paragraph 41); on the European Investment Bank (paragraph 42); on Commission and industry action (paragraphs 43 and 44); and on certain legal delays (paragraph 46) are, at the very least, worthy of consideration. We may wish to take further action on these points.

6. The report does not cover the scope for imposing perfectly legitimate import controls - for example, under Article XIX of the GATT where rapid import penetration threatens serious injury to domestic producers. I do not think this requires further study. But I do think we should remain alert to this possibility.

7. I would also like to comment on Peter Walker's letter of 13 January. I agree with him that our priority must be to get the Community to regulate and preferably much reduce the volume of national aids in agriculture. I suggest that in really blatant cases we should be prepared at least to consider the possibility of ourselves bringing an action in the European Court against an erring member state. I recognise that there may be legal as well as political difficulties in this, but even the threat of such an action may help to keep the Commission up to the mark.

/Second, as his



8. Second, as his letter implies, the option of subsidising our own industries should only be considered in the most exceptional cases. I certainly could not accept, as a general proposition, the view that in the last resort we must be prepared to match a competitor's subsidies. Subsidies to ailing firms or industries have to be paid for out of taxation which either directly or indirectly will impose a burden on efficient and competitive ones. So even in the rare cases where a good argument for a temporary subsidy can be made out, the money would have to be found from within agreed public expenditure ceilings.

9. I am sending copies of this minute to the Foreign Secretary, the Secretary of State for Trade, the Secretary of State for Industry, the Lord Privy Seal, the Minister of Agriculture, Sir Robert Armstrong and Alan Walters.

(G.H.)

25 January 1982



COOPERBROOK

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25 JAN 1982

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AD

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PRIME MINISTER

UNITED KINGDOM TRADING POLICY

Prime Minister

This subject is

planned for an E meeting (but not in the immediate future).

Mks 22/1

*B/P 2
Annat DWright 1/2
How Jan have we
for with the review 1
the responsibility for
standards
② with regard to
asymmetries - I still
think we have
not refer to
the Commission
not*

In circulating the report by officials on this subject which was commissioned at a meeting which you chaired on 4 September 1981, John Biffen invited colleagues to take note of the points in his covering letter rather than endorse the recommendations in the officials' report. I do not think that the report should be put on one side. Although there is much in John's remarks which which I can agree, the report does contain some lines of enquiry which should be pursued.

2 I am persuaded by the report that it is not right to think of a major campaign for covert protection. Because its impact would necessarily be haphazard, covert protection would be unlikely to help industries suffering the most competition from imports. Moreover, covert protection is difficult to organise effectively and, if carried to any great lengths, would not in fact remain covert and would thus invite legal challenge both at home and from the Commission; it would also encourage retaliation from Community partners whose legal systems and habits of mind would be likely to make their retaliation more effective than anything we might achieve. I also agree that economic measures which bear directly on imports, such as action on the exchange rate or quotas, would be more effective in reducing imports in aggregate, if such were our objective.

3 However, I am also conscious that there are many sectors of industry which are aggrieved by what they perceive as asymmetries in our trading arrangements which work to our disadvantage. Our partners' mandatory use of standards and their insistence on documentary evidence of compliance, which contrasts to our own relaxed approach, is one example. We should therefore explore those avenues mentioned in the report which look most promising.



On the import side I would single out three:

- i) accelerating VAT on imports;
- ii) use of standards and certification;
- iii) use of port controls.

This has been considered at each budget - other measures in spirit of measures have regarded it - not

I understand that Treasury officials have been asked to reconsider the timing of changing VAT on imports. I would like my officials to be associated with that exercise. Work on the uses of standards has already been set in hand by MISC 14. I would like to see further study of the use of port controls to ensure compliance with regulations such as, though not confined to, those involving health and safety. Industrialists find it difficult to understand how products whose use is illegal can be permitted to enter the country at all. The introduction of controls against this practice would have a significant psychological impact. We should not be put off looking at a commonsense step simply because legislation would be needed to make the change.

Number referred to before?

4 We should, in addition, remain alert to any opportunities which may arise to temper the wind to exposed sectors when this can be achieved as an incidental by-product of measures which are legitimate in their own terms, such as the ban on sperm whale oil.

5 On the export side, I am impressed by the range of options which the report presents (at paragraph 43) through which we could pursue a more positive line in the Community to remove non-tariff barriers. The fact that there are few feasible options on the import side should encourage us to push the export options in a determined way. In this as in some other areas of Community action, we have allowed ourselves to adopt an

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ambivalent attitude on Commission initiatives, willing the ends - the completion of Community markets - but not the means which the Commission would need in order to achieve this task. I would like to see the fullest exploration of the "Cassis de Dijon" approach to non-tariff barriers which offers the prospect of more rapid progress than is being achieved by the Article 100 programme. I would also like urgent attention given to the problems which have arisen in connection with the Low Voltage Directive. Our manufacturers have registered their concern that this Directive be fully implemented.

6 Since the report was completed, I have noted the French initiative which they call "the reconquest of the internal market". This is a particular example of threatened protection by another Member country where we should be quick to support - or even to stimulate - action by the Commission.

7 I am copying this to recipients of John Biffen's minute of 23 December.

PJ

P J

20 January 1982

Department of Industry
Ashdown House
123 Victoria Street

CONFIDENTIAL

21 JAN 1982

1 2 3 4 5 6 7 8 9 10 11 12

CONFIDENTIAL



MINISTRY OF AGRICULTURE, FISHERIES AND FOOD
WHITEHALL PLACE, LONDON SW1A 2HH

From the Minister

CONFIDENTIAL

PRIME MINISTER

MS

Prime Minister

As you requested, I am
arranging a meeting on this.

MS 13/1

13 January 1982

UNITED KINGDOM TRADING POLICY

The Secretary of State for Trade sent me a copy of his minute to you of 23 December, commenting on the report by officials on UK trading policy.

I do not dissent from his recommendation that we should adopt a pragmatic approach on protection, rather than set out deliberately to provide covert protection wherever we can. I would, however, be very concerned if I thought that pragmatism could become a synonym for inaction, particularly in my own field of agricultural trade, where we face potentially very serious problems.

My concern is with the threat to our industry from subsidised competition from other member states of the Community. There is no doubt at all that the French in particular are determined to expand their agricultural exports by whatever means comes to hand, and our market is an obvious target for them. I have maintained the strongest pressures on the Commission to tackle effectively the whole problem of national aids. But the Community rules against them are often loose and ambiguous, and where they are strict they are seldom enforced effectively. At present a country which wants to attack another's market with subsidised exports and can afford the cost can usually find means of doing so.

/There are basically ...

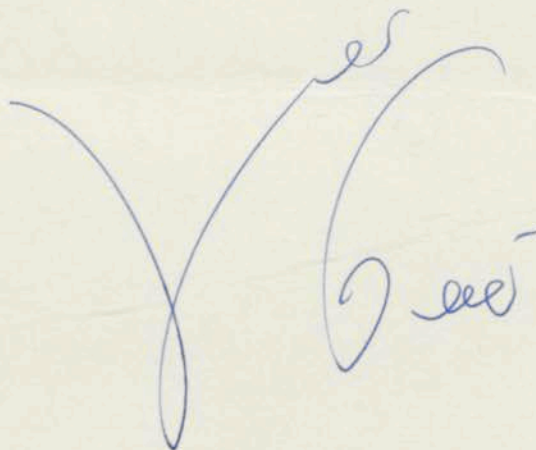
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There are basically only three possible answers to challenges of this kind. One is to tighten up the Community's rules and ensure that they are enforced. I shall continue to do all I can to achieve this, but given the attitude of other member countries I am not hopeful of anything approaching total success. The second is to counter other people's subsidies with subsidies of our own; but that of course can be very costly. The third is to find other means of affording protection, as we have with our poultry health measures and with the public health measures which exclude imports of prepacked liquid milk. But both these measures are under challenge in the European Court, and although we have a strong case in law on both issues that does not guarantee success. Once Community law has been declared by the European Court it will of course be possible, because the European Communities Act makes Community Law the law of the land, for any one to secure immediate redress from our own courts against any attempt to give protection in breach of the law so declared.

This is an extremely difficult situation. As the Secretary of State for Trade says, we shall need to approach it pragmatically. We shall need to consider very carefully each step in the direction of harmonising legislation, so as not unnecessarily to make rods for our own backs. Where harmonisation is incomplete, we should be prepared to consider what use we can make of our national discretion in particular cases, even if this runs counter to our overall approach. And if all else fails, we shall need on occasions to subsidise our own industries so that they can withstand subsidised competition, just as we have had to do in the case of glasshouse horticulture. What we cannot in any circumstances do is simply to stand by and watch otherwise viable British industries be undermined or wiped out by subsidised competition.

I am sending a copy of this minute to the Chancellor of the Exchequer, the Secretary of State for Industry, the Secretary of State for Trade and the Lord Privy Seal, as well as to Sir Robert Armstrong and Alan Waters.

A large, stylized handwritten signature in blue ink, consisting of a large 'V' shape followed by a loop and the letters 'ee'.

PETER WALKER

CONFIDENTIAL

13 JAN 1962

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CONFIDENTIAL

10 DOWNING STREET

From the Private Secretary

11 January 1982

ds
bc Duguid

B/F 22/1/82 to MCS Re RTA arranging meeting

Trade Policy: Overseas Projects and Non-Tariff Barriers

The Prime Minister was grateful for your Secretary of State's minute of 23 December covering an official report on whether trading arrangements both within the European Community and with the rest of the world could work to the UK's advantage. She has also seen your letter to me of 15 December with the attached summary of how our main trade competitors direct their export efforts.

The Prime Minister has decided that she would like to hold a small meeting to discuss both of these papers together. Either I or Sir Robert Armstrong's office will be in touch with you and with the other departments concerned to set this up.

I am sending a copy of this letter to David Wright (Cabinet Office) and Gerry Spence (CPRS).

M. C. SCHOLAR

John Rhodes, Esq.,
Department of Trade.

CONFIDENTIAL

VUB



CONFIDENTIAL

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Prime Minister

I expect comments on the Trade papers from Industry and the Treasury, as well as from the

7 January 1982 Policy Unit.

Qa 05767

To: PRIME MINISTER

From: J R IBBS

Yes not

Content for me to set up a meeting, as proposed?

MUS 8/1

Trade Policy: Overseas Projects and Non-Tariff Barriers

1. I read with interest the summary of the ways in which our main competitors direct their export efforts, attached to John Rhodes's minute to your Private Secretary, dated 15 December.
2. I agree that many of the policy instruments used in each country are unique to the particular combination of institutions and traditions which they have evolved over the years. But what sets us apart from our competitors is their success in first drawing up priorities and then articulating already available policies and programmes to achieve their objectives; I note from the paper that the West German Government (as well as the French and Japanese) has clear views on priorities for support. By contrast, the minute argues that we should 'be guided by the opportunities that the main UK companies want to pursue', and that 'the main problem is to encourage disparate UK interests to work together'. Neither the minute nor the paper proposes any further action aimed at bringing greater selection or coherence to the support of export projects by Government Departments. Yet, unless we do this, we run the risk of ceding our shares in important markets to aggressive and well co-ordinated competition. Continuing world recession, with low or no growth in developing countries, will exacerbate the situation.
3. We, like our competitors, have a variety of financial support instruments at our disposal: ECGD, the aid programme, the aid for trade provision, the Industry Act support. But available resources are being squeezed. It therefore makes sense to examine ways of deriving greater overall benefit from them through support of carefully chosen projects. At present a few large projects (such as the Paradip steel works) absorb



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a large share of the available resources, without any systematic assessment of the overall cost and benefit to the UK economy. And a good deal of aid goes into declining sectors such as shipbuilding. Our work on space policy suggests that the success of sunrise industries such as satellites, communications systems and information technology depends heavily on exports and in particular gaining a foothold in the developing countries; this will require a degree of priority in Government support.

4. I have also seen the minute of 23 December by the Secretary of State for Trade covering an official report on how our trading arrangements both within the EC and with the rest of the world could be made to work to the UK's advantage. As with exports, he recommends no further action.

5. The report by officials identifies a number of small but useful initiatives which, if taken, would go some way to meeting the concerns you expressed when you asked the Secretary of State for this piece of work. In my view many of these proposals are worth pursuing and in particular those concerned with helping exports.

6. There is an important link with exports and the first paper. One factor in export success is to accelerate the dismantling of trade barriers erected by other countries, such as customs inspection and mandatory certification to safety standards. This is in line with the Secretary of State's own preference for removing obstacles to exports rather than taking covert protective action at home. Negotiating these barriers away is something which can only be done by the Government, from a position of strength. It cannot be achieved by industry on its own. It seems to me questionable whether present departmental attitudes, and fragmented organisation, will be effective in carrying this through.

7. More broadly, there is the question implicitly raised by both papers, whether Government policies are sufficiently geared to supporting those sectors and products where the UK has an opportunity to develop a competitive advantage, first in the home market and then overseas.



CONFIDENTIAL

8. It would therefore seem desirable to discuss both papers together, whether at EX Committee or in some other forum. It should be possible to have a short paper drawing out the linkages and suggesting priorities for further action.

9. I am sending a copy of this minute to Sir Robert Armstrong.

SR

CONQUEROR



Trade

10 DOWNING STREET

NOTE FOR THE FILE

Mr. Goodenough in the Cabinet Office telephoned to ask whether we were awaiting Cabinet Office advice.

I said that we were at present waiting to see whether CPRS would comment, and whether other Ministers would do so.

Cabinet Office will wait a few days, and will then put in advice on the basis of comments received.

MA

30 December 1981



cc LCD .

So

10 DOWNING STREET

From the Private Secretary

30 December, 1981.

The Prime Minister has asked that the Attorney General should see the attached minutes from the Secretary of State for Trade and the Lord Chancellor, about certain aspects of a review of UK trading policy which has been undertaken by Department of Trade officials.

There may be a meeting of Ministers in due course to consider the recommendations of officials submitted by Mr. Biffen, but in the interim, the Prime Minister agreed with the Lord Chancellor's request that the papers should be seen by the Attorney.

M. A. PATTISON

Jim Nursaw, Esq.,
Law Officers' Department.

FROM:

THE RT. HON. LORD HAILSHAM OF ST. MARYLEBONE, C.H., F.R.S., D.C.L.

ce. A. Duguid



HOUSE OF LORDS,
SW1A 0PW

①

CONFIDENTIAL

Prime Minister

Prime Minister

The CPRS and the Policy Unit may well wish to put views to you on Mr Biffen's minute + paper (attached). Agree to wait until then before deciding whether a meeting is required to reach conclusions on officials' recommendations?

Yes no

United Kingdom Trading Policy

I have received John Biffen's minute to you of today's (para 47 of date to which is annexed a note by officials on United Kingdom Trading Policy. Since I am not a member of E Committee, this is the first that I have seen of the matter; and I must say at once that I am somewhat surprised that without consultation with the Lord Chancellor's Department officials should have been asked to consider whether any action might be taken to make Community law less immediately binding in our courts (paragraph 2(iv) of the note). My surprise increased when I looked at paragraph 36 of the Report. This paragraph canvassed the requirement of the Attorney General's or the court's consent to legal proceedings involving our treaty obligations, the transfer to the Chancery Division of all cases of the same class with a view to their prolongation, action by the Government to delay proceedings in court by protracting its pleadings, and other measures which can only be described as devices by the executive to tamper with the course of justice. These are steps which, if taken in the context of domestic proceedings, would be severely and rightly criticised by the court as an infringement by the executive of the independence and integrity of our judicial system. I am glad to see that officials have rejected these devices, but I feel that they should not have been asked even to consider them without my being consulted first, and had I been so consulted I would not have been a party to a decision to ask officials to consider ways of tampering with the procedure of the courts with a view to gaining economic or political advantage. If such measures were taken it would be difficult to overestimate the damage to the prestige of the Government and the sense of outrage which would permeate the judiciary and the whole legal profession.

Agree to
on copying

the
papers
to me

Attorney?

MS 24/12
Yes no

/Contd.

CONFIDENTIAL

CONFIDENTIAL

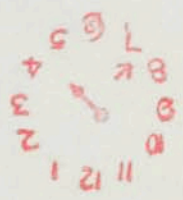
I am sending a copy of this minute to John Biffen, but not to other recipients of his minute. I would, however, ask that the Attorney General be shown the papers.

H: of S: M.

23rd December, 1981



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2 3 DEC 1981



PRIME MINISTER

When I was asked to commission the studies in the attached report by officials, I believe that we were all concerned that strict observance of the accepted trading rules might somehow be giving us the worst of all worlds, whereas with only a little deviousness we could in fact secure the best. Now that I have read all forty-seven paragraphs of this report, I ask my colleagues to accept that neither version is a realistic assessment. I am impressed by three points.

First, officials have presented a number of possibilities for covert protection. They suggest these might be pursued further. I accept that they have probably identified the least unpromising material. I should, however, be reluctant to elevate such possibilities into a serious policy option. Furthermore, I doubt the value of these measures of covert protection for particular product sectors which further investigation might select for experiment.

Second, I am not altogether surprised how little of substance should have been turned up. In slightly different terms, this exercise has been conducted for us twice before. I do not think it has much to do with easing the adjustment of declining industries or helping inherently viable industries to overcome short-term difficulties, whatever may be alleged in the conclusions (paragraph 38). Indeed I was interested that the CBI did not rise to this bait in the recent NEDC discussion on non-tariff barriers.

If we are seriously anxious about trading rules which imperil our freedom of action at this more fundamental level and which are written to suit the economies of others but not necessarily



our own, I suggest that we should bring that anxiety to bear on our current reflections on the merits of joining the EMS. The ability to determine our own sterling exchange rate is of paramount importance. It is fundamental in securing our trade balance, and could dwarf whatever might be secured by the laborious erection of non-tariff barriers.

Third, I am sure there is room for pragmatic action - either to secure our Treaty rights or to provide deliberate or open protection where we can. Quota and restraint arrangements - not mentioned in the paper - already provide more significant protection than any new standards regime or port controls could hope to afford. We should continue with this pragmatic course. Likewise we must maintain the strong anti-dumping unit in my Department. I can see that certain sectors may merit alternative shelter where helpful regimes are expiring and that we should look at these. We must continue to do all that we can to secure more patently open trade in the European Community. And of course if the Commission seem out of touch with political sense in a practical case like the London taxi we must respond sharply.

Such a pragmatic approach, however, is markedly different from enacting a deliberate framework of covert protection which it would be difficult to monitor and cost. So rather than inviting my colleagues to endorse officials' recommendations, I ask them simply to take note of the points which I have made above.

W J B

Department of Trade
1 Victoria Street
London, SW1H 0ET

W J B

23 December 1981

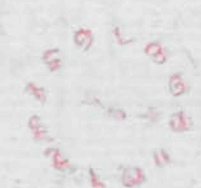
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UNITED KINGDOM TRADING POLICY

Note by Officials

INTRODUCTION

1. At an ad hoc meeting of Ministers chaired by the Prime Minister on 8 September the Secretary of State for Trade was invited to arrange for a study to be carried out of possible ways in which the United Kingdom's trading arrangements both within the European Community and with the rest of the world could be made to work more to the United Kingdom's advantage (the relevant extract from Mr Lankester's letter of 9 September to Mr Kerr is annexed).
2. In response to this remit, this Note first sets out a number of general considerations relevant to the report as a whole and then -
 - i. reports on the progress made in introducing new non-tariff barriers in the four areas discussed when E Committee considered a similar exercise in June 1980 (E(80) 21st Meeting, Minute 3);
 - ii. assesses what further scope may exist for taking covert action to protect United Kingdom industries;
 - iii. considers how the Commission might be enabled or persuaded to improve their monitoring of illegal and unfair trading practices in other Community countries, and to take firmer action against such practices;
 - iv. briefly compares legal procedures for enforcing Community law in the United Kingdom and other member states; and considers whether any action might be taken in the United Kingdom to make Community law less immediately binding in our courts;
 - v. proposes conclusions and invites Ministerial endorsement or decisions as to further work.

3. The Note has been prepared under Cabinet Office chairmanship by a group of officials from the Departments of Trade, Industry and Employment, the Treasury, the Ministry of Agriculture, the Foreign and Commonwealth Office, the Lord Chancellor's Office, the Law Officers' Department and the Central Policy Review Staff.

GENERAL

4. There is an obvious potential conflict between 2(ii) and 2(iii) above ie between introducing further covert measures to protect United Kingdom industry and trying to get the Commission to take firmer action under the Treaty of Rome against similar practices in other Community countries. The risk of conflict would rise with the scale of any new covert action and its vulnerability to exposure. This does not mean that it is impossible to ride both horses simultaneously, and the need for defensive action by us will be the greater the less we are able to persuade the Commission to take effective action against others. However, any substantial strengthening of the present trade regulatory system to permit effective protection of all threatened sectors of British industries would not be compatible with the United Kingdom's obligations under Community law.

5. Officials have assumed, subject to further guidance, that Ministers would wish them to start by considering what steps might be taken to deal with known problems within the existing trade regulatory framework. This would stop short of any open breach of the United Kingdom's Community obligations but would not exclude bending the rules where we might hope to do so without being found out. Since much of this ground was gone over in last year's E Committee exercise the results of this new work are limited. Covert action on the scale envisaged could not be expected to have more than a marginal impact on imports, or to produce even these results quickly in some areas. Ministers may wish to consider the results of this work before deciding whether officials should organise a more comprehensive inventory, on a product by product basis, of the possibilities for covert action and identifying those where the conflict with other policies would not arise or could be minimised.

6. Certain other general points are also relevant -

i. it appears from a number of recent statements by the CBI, and from the debates that took place at their annual conference in October, that their members attach prime importance to the removal of the non-tariff barriers (NTBs) sheltering their competitors; they are not looking for protection against fair competition. Almost as important, they now reluctantly accept the distinction between the extensive but legitimate non-tariff requirements which have to be complied with and protectionist NTBs which are relatively fewer;

ii. in the negotiations on the 30 May mandate we have supported the Commission in giving a higher priority to completion of the internal market in goods and services. The Minister of State for Foreign and Commonwealth Affairs (Mr Hurd) made a major statement on the United Kingdom Presidency's programme and priorities for the development of the internal market in a European Parliament debate on 14 October. Working through the Commission against unfair competition from our partners would fit well with this approach and that of the CBI. Conversely, any substantial programme of covert action might be difficult to sustain for long without calling in question our good faith in publicly committing the the United Kingdom to collaborate in making a Community-wide common market for goods and services a reality;

iii. on the basis that British industry has generally more to gain from eliminating NTBs in its export markets than from creating or retaining them at home, the United Kingdom has supported the GATT code on non-tariff barriers and programmes for harmonisation of standards and related exercises within the Community. Nevertheless it has been our policy to defend United Kingdom requirements which have a protective effect where no gain can be seen from harmonisation. In some cases harmonisation would mean giving up national powers which might be incidentally useful for protective purposes. The possible need to retain such powers as well as the possibility of introducing new measures which would have some protective effect should be considered in the same pragmatic way without prejudicing the principle that overall priority should be given to harmonisation.

iv. it is in the nature of covert action that it cannot be prayed in aid publicly. This may diminish its political and presentational attractions; but if the desired result is brought about the intended beneficiaries, at least, may be expected to know what is going on.

FOLLOW-UP TO E COMMITTEE REMIT OF JUNE 1980

7. Progress on the four non-tariff barriers has been as follows -

The accelerated payment of VAT on imports

8. After discussion between the Prime Minister and the Chancellor of the Exchequer in the context of the 1981 Budget, it was decided that such a scheme, although superficially attractive, had many drawbacks and should not be proceeded with.

Sperm whale oil

9. Agreement was reached in the Council of Ministers in December 1980 on a Community ban on the import of sperm whale oil and products containing such oil. The ban will come into force in January 1982. Once the effect has worked through, this should provide some protection for the United Kingdom's tanning industry.

New National Safety Standards

10. Recognition by the Health and Safety Executive (HSE) of Safety Standards gives legal advantages to firms manufacturing to those standards who are likely to be British. Procedures for statutory recognition of 10 safety standards are now under way.

- BS 4683 - Electrical Apparatus for flammable atmospheres
- BS 4343 - Industrial Plugs and Sockets
- BS 4752 - Circuit Breakers
- BS 5419 - Air Break Switches
- BS 1870 pt. 1 - Safety footwear
- BS 5426 - Workwear

- BS 1397 - Safety Belts
- BS 697 - Rubber Gloves
- BS 5240 - Safety Helmets
- BS 5169 - Fusion Welded Air Receivers

11. Consultation will be completed by the end of this year. A difficulty is that some users and consumers are opposed because of the effect of recognition on the range of choice. In the light of this consultation a decision will be taken. Meanwhile other possibilities for recognition are being examined.

National Type Approval Scheme for Goods Vehicles

12. This scheme has now been adopted, and has put the United Kingdom on a similar footing to other member states in subjecting commercial vehicles to a series of tests before being sold here.

THE SCOPE FOR FURTHER COVERT PROTECTION OF UNITED KINGDOM INDUSTRIES

13. Officials have taken covert protection to mean protection afforded as the apparently incidental by-product of action undertaken for other purposes. The scope for such action would therefore lie in fields such as health and safety, consumer protection, national defence, public purchasing, environmental protection or the style of public administration: all fields in which national procedures while subject to limitations, are not completely excluded by the Treaty of Rome. We have not considered the possibility of subsidising United Kingdom industry and agriculture to match the aid given to their competitors by some member states. For the time being not all the Departments and agencies which could be involved have been consulted.

14. Certain constraints bear on what can be done:

- i. given that covert measures would be a by-product of action undertaken for other purposes and that this latter action must conform with the relevant statutory instruments, it may not be possible to direct this form of protection at the areas where it would be most welcomed by the industries concerned;

ii. powers given for a particular purpose may not lawfully be used for other purposes. Importers could have recourse to the Courts and the Ombudsman and thereby obtain indirect or direct relief against misuse. Some of the Departments or agencies concerned are circumscribed by the legislation under which they operate and by the risk of challenge in the Courts from taking covert protectionist action - eg, in the occupational health and safety area. Even where Departments or agencies could use legitimate discretion in ways which would have a protectionist effect, in some cases a measure of public consultation would be inescapable before new regulations could be introduced. Furthermore, unless more staff were provided, the use of powers in this way would have the effect of diverting effort away from the primary functions of the Departments or agencies concerned.

iii. there would be some risk of retaliation from our trading partners, as well as of a challenge from the Commission and eventual adverse judgment by the European Court and there could be complaints from importers whose deliveries were delayed, with the possibility of actions for damages against HM Customs and Excise;

iv. protection of some United Kingdom firms might be achieved only at the expense of others if for example it had the effect of reducing the availability of cheaper imported inputs and components;

v. more central or local government staff would be needed to implement many of the protective measures identified if this had to be done without diverting effort away from existing tasks; alternatively priorities would need to be re-assessed and some existing work dropped to make room for the new;

vi. particularly in the case of agriculture, the comprehensive, detailed and directly applicable character of Community legislation, as well as the ready availability of legal remedies to individuals affected by infringements of this legislation, impose major restrictions on the scope for unilateral action.

Standards, testing and certification requirements

15. The formulation of improved national standards, the mandatory application of recognised standards (national, EC or internationally agreed standards) and the enforcement of national testing and certification procedures are measures which severally or collectively can be used to improve the efficiency of British manufacture. MISC 14 has already commissioned urgent studies for this purpose within the framework of existing legislation. They could be extended to afford marginal covert protection in some product sectors. However there are certain constraints common to the effective use of such measures for either purpose:

i. The mandatory application of standards and the enforcement of national testing and certification procedures is possible under existing statutes only if this contributes to their clear purpose - road safety, consumer protection, health and safety at work. In some cases, it may of course be practicable to serve both these safety interests and those of the manufacturers.

ii. Depending very much on the product concerned the formulation of unique national standards and more particularly their mandatory application can add to the production costs of British manufacturers wishing to serve both home and export markets.

iii. Both the GATT and the Treaty of Rome outlaw the use of standards as well as associated procedures for protective purposes, although Community jurisprudence is still in a formative stage in defining the frontier, under Article 36 of the Treaty. Moreover their use could fall foul of the competition Articles of the Treaty.

16. All these considerations would have to be taken into account on a product by product basis. As will be apparent from paragraphs 10-11 above, standards writing is a slow business; moreover sizeable additional resources (both public and private) could be involved.

Port Controls

17. We have explored the scope for using controls at the port as a non-tariff barrier. This might be possible in the few cases where import quotas, compulsory standards and special import arrangements exist. At present Customs lack the legal powers to enforce standards in ways which bear as heavily on imports as comparable regulations in other countries. For example, where mandatory technical standards exist governing the safety of machinery, the Customs have no authority to require that imports should satisfy these standards. It is not therefore possible, where individual foreign items are found to be unsafe, for action to be taken to ban the sale or importation of similar items until the defect has been eliminated. As a result imports have taken place of radio and telephone equipment which could not lawfully be operated in the United Kingdom. Other countries often require certificates of compliance with compulsory standards to be checked at ports. This requirement does not exist in the United Kingdom. Introducing controls of this kind would require further study. There have also been complaints by industry that, where import quotas exist eg in the case of textiles, the scale of checking by Customs at the port is not adequate to prevent evasion.

18. We have also explored the possibility of using import controls to supplement local consumer standards authorities' control of dangerous goods, particularly electrical goods. A system of certification of such goods could provide an effective non-tariff barrier. But such a system would give rise to a number of practical problems, would be vulnerable to challenge under the Treaty of Rome and would probably require new legislation. Given these uncertainties, this possibility does not look worth following up either as a non-tariff barrier or as a means of helping local consumer standards authorities.

19. We have also considered whether a similar result could be achieved not with more controls at the ports, but less. Some countries are believed to have set out to delay selected imports by reducing staff (or man hours) available for inspection, processing documentation etc and/or by closing points of entry for particular goods. Not only the basis on which HM Customs handle clearance but also the basis on which consignments are made up by shippers etc mean that it would be impossible to distinguish particular categories of goods in this way from

the generality of imports. Since any attempt to introduce selective impediments would in practice therefore lead rapidly to general congestion, not only would protest be widespread but also the measure could not be covert. Indeed where such practices have had perceptible effect elsewhere they have attracted the early attention of the Commission (eg Italy's closure of certain customs posts previously used for textile business).

Country of Origin Markings

20. Some sections of industry frequently suggest that compulsory country of origin marking should be required on a wider range of goods, or that it should be required at the time of entry into the United Kingdom rather than at the point of retail sale. This last requirement has been imposed by France. But since these French measures and the origin marking requirements announced this year by the United Kingdom for introduction in January 1982 are already both being challenged by the Commission, it does not seem fruitful to pursue this issue on a broad front at present. The French may be about to withdraw their measures.

Public Purchasing

21. Large sections of industry argue that more positive use could be made of public purchasing to promote competitive manufacture through such actions as framing tenders to suit United Kingdom producers, early notification of possible requirements, development contracts, use of certification schemes and the quoting of British Standards in specification.

22. The Government already uses these devices. They have to be treated with care, as any general move towards national purchasing within the Community would affect our industry's exports. Moreover, the GATT rules on public purchasing and Article 30 of the Treaty of Rome together with the EC Supplies Directive limit what we can be seen to be doing. The Commission have already begun to investigate the purchasing practices of United Kingdom local authorities; they have identified five cases and suspect that these may be only the beginning. So any scope for more intensive informal lobbying by Departments of local authorities' associations and nationalised industries would need to be treated with great care.

23. Officials conclude that there are particular areas in which the United Kingdom is already doing a good deal to help British industry; that, in view of the relatively high degree of transparency on public purchasing matters which prevails in the United Kingdom, there is little scope for systematic action beyond what is already being done; but that we should maintain our present approach domestically and, wherever possible, press the Commission to attack the practices of others.

Animal Health

24. The import restrictions recently imposed in connection with the move to a slaughter and compensation policy for Newcastle disease in poultry are under legal challenge by the Commission, who have now initiated proceedings against the United Kingdom in the European Court. The scope for similar unilateral action on animal health grounds in other fields is circumscribed by Community legislation, but could be examined further when the outcome of the Newcastle disease case is known.

Industries where existing Protective Regimes have disappeared or may disappear

25. Particular pressures for protection may be expected to emerge in respect of the following sections in which various existing buffers against competition from imports have disappeared or may do so in the near future:

- i. Colour TV - when existing patent protection expires over the next four years;
- ii. Telecommunications - the removal of the British Telecommunications monopoly on the supply and installation of equipment on the public telephone network is likely to make the United Kingdom market more open to imports;
- iii. Electronic Computers - the ending of Government preference for ICL;
- iv. Smelting and semi-manufacturer - pressure from the EC (which will be difficult to resist) to make concessions on aluminium and copper imports in agreements with state trading countries;

v. Milk - if the European Court finds against the present United Kingdom health and hygiene regulations which have the effect of impeding imports of liquid milk. Judgment is expected in the first half of 1982;

vi. Glasshouse Horticulture - temporary aid is currently provided to enable United Kingdom producers to withstand unfair competition from Dutch importers benefiting from preferential gas prices. The Commission called on the Netherlands Government to eliminate their subsidy by October 1982 and not to widen the differential with fuel prices charged to other Dutch users meanwhile. Ministers have recently decided to extend the United Kingdom aid for a further year;

vii. Poultrymeat and eggs - if the European Court finds against the United Kingdom measure introduced in August 1981.

Further work would be needed if a detailed appraisal of possible forms of protection were required.

OTHER PROTECTIVE MEASURES

EIB Tendering Procedures

26. Work is already in hand on improving United Kingdom manufacturers' performance in tendering for European Investment Bank (EIB) projects generally. Officials have examined the case for seeking to persuade the EIB to adopt a policy of confining the right to tender for EIB investment projects to the country where the project is located and the member states of the Community, thus eliminating competition from the rest of the world. On the sketchy information available United Kingdom firms might stand to win some £2-5 million of extra business a year from restricting the right to tender in this way. Certain industries eg process plant, might benefit particularly; and there might be political advantage in Ministers being able to point to such a change in EIB tendering procedures.

27. On the other hand, in 1980 some 45 per cent of the EIB's finance was raised outside the Community, much of it in those countries which would suffer most from such a change: USA, Japan, Austria and Switzerland. Our contacts in the

EIB believe that their future borrowing, especially in Japan and Switzerland and perhaps also in the US, might be adversely affected. Moreover to rule out US firms could undermine the viability of United Kingdom projects which rely at present on imports of US plant and machinery.

28. Our conclusion is that the potential gain of a formal change in policy is not worth the risk of hampering the EIB's ability to raise the funds it needs on the world's capital markets. But the United Kingdom's EIB Directors should support those who wish to see a greater degree of Community preference in tendering wherever possible.

Anti-dumping

29. Some industries feel that present Community procedures and practices make it too difficult to get anti-dumping duties imposed, and that some degree of protection is forfeited as a result. Such action cannot be covert since anti-dumping duties can only be imposed by the Community; but we are already doing what we can to help United Kingdom industries to make their case for Community action through the Department of Trade's Anti-dumping Unit, which gives general advice on procedure as well as help in the detailed preparation of individual anti-dumping cases and support at meetings with the Commission to consider cases.

COMMISSION ACTION AGAINST ILLEGAL AND UNFAIR PRACTICES IN INTRA-COMMUNITY TRADE

30. The following considerations bear upon the choice of action under this heading -

- i. Detailed enquiries recently made of industry by the Department of Trade and NEDO have separately confirmed that although non-tariff requirements facing exporters are numerous and demanding they are not as extensively protectionist as is often suggested. Since extra staff would be required, both in member states and the Commission, to secure any significant reduction of such requirements (either, where they are justifiable, by promoting Community harmonisation or, where they are illegal, to discipline their use) the extra costs involved would have to be set against the likely benefits.

ii. The scope for more effective Commission action is limited by three factors in particular:

- a lack of precision, which is only gradually being supplied by judgements of the European Court and by Community directives, in some of the key provisions of the Treaty of Rome.

- the problems faced by the Commission in finding the necessary firm evidence on which to base any action. This explains why the Commission recently sought an extension of their powers of enquiry into public undertakings, but some member states including the United Kingdom have challenged this extension out of concern that the Commission should not improperly gain power at the expense of the Council and individual member states.

- difficulties in enforcing the Commission's rulings and the judgements of the European Court.

iii. Opinion in many member states is that only the effective control of state aids would have any significant economic impact on unfair (and sometimes illegal) conditions of trade within the internal market. We would not dissent. But more effective action on state aids depends on obtaining the support of member states as well as the agreement of the Commission.

31. Against this background, we have identified the following main possibilities -

i. the harmonisation of national standards and technical regulations under Article 100 is extremely slow and uncertain. With increased resources the programme could be speeded up. (Alternatively, involving less resources and with more certain effect, the Commission itself could cut through the undergrowth with the delegation of the necessary powers under Article 155: but the United Kingdom has not so far favoured such an extension of Commission power.)

ii. An alternative course to harmonisation of standards etc is embodied in the Commission's reaction to the so-called Cassis de Dijon judgement - very crudely that whatever is legitimately manufactured and marketed in one Member State must be allowed unimpeded access in the rest of the Community. If this were to spill over into accepting access for third country goods it would certainly encounter the opposition already offered by most Member States to proposals for simplifying testing and certification procedures for such trade once in free circulation. Within a strict Community context, however, it may be desirable to encourage the Commission to deploy that judgement selectively either to cut short political obstruction to harmonisation Directives (eg the French vetoes on whole type vehicle standards) or to side step altogether the need for harmonised standards. Given the variety of local conditions, particularly in an enlarged Community of Twelve, however, the judgement will not be regarded as a simple and complete answer to different national standards.

iii. the central registration of national technical requirements in one or more of a number of possible forms which could help the Commission to open disciplinary action (but to be effective it would be costly);

iv. mutual acceptability of testing and certification procedures, now largely secured on a bilateral basis with Commission encouragement, might be put on a multilateral footing within the Community, eg a Council resolution in robust enough terms to permit the Commission to intervene where progress was slow. For the United Kingdom to participate in this, we should need to make wider use of certification procedures;

v. The United Kingdom might support the recent German call for a comprehensive listing of state aids, with a view to the Commission's rigorously enforcing the Treaty to require the dismantling of many aids;

vi. agreement in the Council on a comprehensive set of decisions, by either sector or product, to regulate national state aids as has been done for export credit subsidies, steel, textile and shipbuilding aids. Experience in these fields suggest that Council decisions on these lines would greatly increase the effectiveness with which the Commission could exercise their existing powers.

If Ministers consider that any of these possibilities would be worth pursuing further work would be needed to explore them fully.

32. In addition the Minister of Agriculture has already called for a comprehensive attack on the problem posed by State aids in the agriculture sector, and will continue to press for effective action, taking full advantage of the Commission's own acknowledgement that reform of the common agricultural policy must include action on state aids.

33. Certain other measures, whose main effect would be to promote public confidence in the United Kingdom that the Commission were committed to free circulation and had the ability to implement it, could be taken straightaway. They might also marginally improve the Commission's effectiveness in this field. The Government might -

i. encourage closer contact between bodies representative of industry (particularly UNICE) and the Commission. The former might usefully take on some of the burden of eg identifying the more disruptive practices and the more useful areas for new common standards;

ii. encourage United Kingdom industry to make greater use of the Commission's willingness to act as an honest broker, ready to intervene on industry's behalf with the authorities of other member states informally and without legal prejudice. Such action would be useful in facilitating the mutual acceptance of slightly differing standards or in removing minor bureaucratic hurdles or unintended obstacles;

iii. encourage the Commission to explain more fully the reasons for their decisions not to take up particular complaints. This might help business opinion to understand the constraints under which the Commission work and thus improve their confidence in the Commission;

iv. systematically offer the Commission suggestions on the relative priority they should give to the multitude of suspected infringements brought to their notice.

ENFORCEMENT OF COMMUNITY LAW IN THE DOMESTIC COURTS OF THE MEMBER STATES

34. The only provisions of Community law which may be relied on by individuals in domestic courts are those which have direct effect. They include provisions on the control of imports and the notification of state aids. If a provision has direct effect it is automatically enforceable in the courts of member states and takes precedence over conflicting domestic law.

35. For one or more of the following reasons, the enforceability of those provisions of law seems to be less effective in certain other member states than in the United Kingdom -

i. the existence of special administrative courts, with procedures favourable to the Government, to hear certain types of action against it;

ii. the delays inherent in legal proceedings and lack of an expedited procedure for urgent action especially in cases before administrative tribunals;

iii. the pressure put on individuals not to pursue claims in the domestic courts;

iv .the apparent reluctance of United Kingdom nationals to seek enforcement of their Community law rights in foreign courts;

v. the fact that the law in general is more easily enforceable in the United Kingdom than in other member states.

36. We have examined a number of ways in which Community law might be made less immediately effective in the United Kingdom. These include the creation of a special procedure for the hearing of actions alleging violation of directly effective Community law by the Government or the imposition of the requirement of consent by the Attorney-General or leave of the Court, both of which would be contrary to Community law; the transfer of all cases alleging breaches of international treaty obligations to the Chancery Division of the High Court where proceedings are generally more prolonged; action by the Government to bring about delays by its pleadings; and constitutionally more far reaching measures to set up special tribunals to deal with cases against the Government or to subject such cases to special substantive procedural rules. All these devices are open to practical objections and to the general objection of principle that the Government would be tampering with the law for reasons of expedience. Officials accordingly cannot recommend that any should be pursued.

37. On the other hand, in the majority of cases before the United Kingdom domestic courts where directly effective Community law is an issue, the Government will be able to secure delay by seeking a Reference to the European Court, provided that there is at least a colourable defence in Community law for the action it has taken. Proceedings before the Court can take up to a year, but the average delay is probably about 6 months. A decision to seek such a Reference can only be taken on a case by case basis.

CONCLUSIONS

General

38. There is a potential conflict between taking covert measures to protect United Kingdom industries and trying to get the Commission to act more firmly against similar trading practices in other member states. The one need not exclude the other; but the risk of conflict would increase with the scale of any

new covert action and its vulnerability to exposure. Given the Government's commitment to the maintenance of the open-trading system and United Kingdom industry's own apparent preference, it may be best to put the main emphasis on promoting more effective Commission action, while seeking means of providing limited extra protection within the existing trade regulatory framework to ease the adjustment of declining industries and to help inherently viable industries to overcome short term difficulties (paragraphs 4-6).

Follow-up to E Committee

39. The work done for E Committee last year identified the four most promising covert measures. Of these, one has since been ruled out by Ministers; two have been implemented; and the fourth (new national safety standards) is being pursued (paragraphs 7-12).

Scope for further covert protection

40. Of other possible measures, wider use by Government for regulatory purposes of British standards and national certification procedures appears to be most worth exploring. As noted, such an approach would take some time to work up. Further examination of the detailed possibilities would be needed, including the provision of the necessary resources. It might be found convenient to subsume that examination in the report being made to MISC 14 about strengthening the standards system. Further work would also be needed if Ministers wished to pursue the possibility of using port controls as a non-tariff barrier. (Paragraphs 13-24).

41. Further work would also be needed if it were thought necessary to devise alternative protection for certain industries where an existing protective regime is likely to be reduced or eliminated (paragraph 25).

Overt measures

42. We recommend that the United Kingdom's EIB Directors should support those who wish to see a greater degree of Community preference in tendering for EIB financial projects wherever possible, but that they should not seek a formal change of policy (paragraphs 26-28); and that we should continue to do what we can to help United Kingdom industries to make their case for Community anti-dumping action (paragraph 29).

Commission action against illegal and unfair practices in intra-Community trade

43. Although there are certain constraints on the Commission's capacity to act more vigorously against illegal and unfair trading practices in other member states the following possibilities would be worth pursuing (paragraphs 30 - 32) -

- i. adoption of uniformed Community standards and technical regulations;
- ii. Commission use of the Cassis de Dijon judgement to secure unimpeded access throughout the Community for whatever is legitimately manufactured and marketed in one Member State;
- iii. central registration of national technical requirements;
- iv. Community- wide agreement on mutual acceptability of testing and certification procedures;
- v. comprehensive listing of state aids;
- vi. continued action against state aids for agriculture;
- vii. comprehensive decisions, by sector or product, to regulate state aids in areas not already covered.

44. In addition, a number of confidence building steps could be taken to reassure United Kingdom industry (paragraph 33) -

- i. more contact between representative industry and the Commission;
- ii. encouraging United Kingdom industry to make greater use of the Commission's willingness to intervene with other member states;
- iii. encouraging the Commission to explain more fully the reasons for their decisions not to take up particular complaints;
- iv. offering the Commission suggestions on the priorities they should give to examining infringements.

Enforcement of Community law in the domestic courts of the member states

45. The enforceability of Community law seems to be less effective in certain other member states than in the United Kingdom. None of the more radical devices examined as a means of bringing about the same effect in the United Kingdom can be recommended (paragraphs 34-36).

46. But in the majority of cases before the United Kingdom domestic courts where directly effective Community law is an issue, the Government will be able to secure delay by seeking a Reference to the European Court, provided there is at least a colourable defence in Community law for the action it has taken; this should be decided case by case (paragraph 37).

RECOMMENDATIONS

47. Ministers are invited to -

- i. endorse the conclusions in paragraphs 38-46 above and instruct officials to proceed accordingly, reporting to the Secretary of State for Trade as necessary;
- ii. decide whether further work should be done to explore -
 - a. the possible wider use by Government of British standards and national certification procedures and of using port controls as a non-tariff barrier (paragraphs 15-17);
 - b. alternative measures of protection for industries indentified in paragraph 25.

Cabinet Office

10 December 1981



10 DOWNING STREET

Prime Minister

The Attorney General asks if
the Solicitor General may come to
E tomorrow since he may be
involved in the debate tomorrow
afternoon on the GLC / London
Transport problem?

MCS 21/12



10 DOWNING STREET

Prime Ministers.

Mr Jenkins and Mr
Biffen have not had copies
of the Chancellor's minute and
do not know of its existence.

AHJ

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Secretary of State for Industry

DEPARTMENT OF INDUSTRY
 ASHDOWN HOUSE
 123 VICTORIA STREET
 LONDON SW1E 6RB
 TELEPHONE DIRECT LINE 01-212 3301
 SWITCHBOARD 01-212 7676

18 December 1981

The Rt Hon John Biffen MP
 Secretary of State for Trade
 Department of Trade
 1 Victoria Street
 London SW1

Dear John,

MEETING OF MISC 14: 30 NOVEMBER 1981

I was sorry to read in your letter of 7 December that you do not consider that there should be any discussion about Departmental responsibility for standards as part of our MISC 14 remit to consider improvements to the co-ordination of Government responsibilities for standards and related subjects such as certification and quality.

2 We all recognise that standards have an essential part to play in strengthening British industry by improving the quality and reliability of its products and consequently its competitiveness and performance in both the home and overseas markets. I see my task as Secretary of State for Industry as being to improve industrial performance to the extent that it is possible for Government to do this. I see support for standards as an integral part of an industrial policy which also includes support for investment in new technologies, encouragement of research and development and promotion of enlightened public purchasing.

3 Many of my officials are already heavily involved in standards writing in the BSI and international standards bodies. The Requirements Boards give considerable support to research which leads directly, or incidentally, to the production of better standards. The National Physical Laboratory undertakes a certain amount of work for the National Weights and Measures Laboratory. I am sure that the interests of UK industry would benefit from amalgamation of these two bodies and I believe there would also be a saving of resources.

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4 I quite agree with you that a major part of the task is to change industry's attitudes to the importance of standards but I believe my Department with its close contacts with industry is well suited to tackle this job.

5 I also concur with your view of the complexity of the whole field. I well recognise that in addition to its being a component of industrial policy it has close links with international trade, such as the Article 100 harmonisation programme and with consumer protection, in areas such as consumer safety and metrication. I would like to make it quite clear that I am not questioning existing Departmental responsibility for any of those subjects. I do, however, believe that the Department of Industry has the most vital interest in improving standards and quality and I hope that you will agree that it would be right to examine the question of Departmental responsibility for overall policy on standards and quality and for the National Weights and Measures Laboratory.

6 I thought it would be right to let you have my views in advance of our discussion with the Prime Minister.

7 I have also seen your further letter of 10 December suggesting an ad hoc group chaired by Tony Eden to follow up the remaining parts of the MISC 14 remit. I agree that such a group should be set up immediately without prejudice to the resolution of the question of departmental responsibility. My Department will be represented by Mr C J Farrow.

8 I am copying this letter to the Prime Minister, members of MISC 14 and to Sir Robert Armstrong.

not correct - requested
Yours ever
Patel

RESTRICTED

cc AD.



Prime Minister

Mus 18/12

From the Secretary of State

Michael Scholar Esq
 The Private Secretary to
 The Prime Minister
 10 Downing Street
 London SW1

ms

await CPRES advice

by 4/5 Jan.

15 December 1981

Dear Michael,

OVERSEAS PROJECTS: COMPETITORS' PRACTICES

The first EX meeting, called for an examination of the practices of our main competitors in pursuing overseas projects. Officials in this Department, in consultation with those of other interested Departments, have prepared the attached summaries of how Japan, France, Germany and the USA are structured to tackle this market.

With each having its own distinct combination of industrial structure, financing institutions, domestic market, economic imperatives, traditions of adjustment, and Government involvement, the Secretary of State has concluded that we cannot realistically attempt to duplicate what they do. Especially, there are such glaring differences between the UK and such countries as Japan and France, that it is not feasible to set overriding priorities for industry. Rather, the approach should be to continue to be guided by the opportunities that the main UK companies want to pursue. This does not preclude drawing their attention to particularly attractive markets which they may have ignored, or types of project that they may not have identified.

The potential market for major projects is immense, if concentrated at present in the developing world, and holds out opportunities for the



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75 DEC 1981



From the Secretary of State

full range of manufacturing and services. Our competitors have made a conscious decision to pursue these, and their companies can readily command the range of disciplines and resources necessary to present very attractive packages. If the UK is to sustain its manufacturing base and market position, clearly industry must win its share. More particularly, in the current recession, projects won generate orders, and hence employment, rapidly. Furthermore, when the Government provides support it has the assurance of doing so to the more competitive and combative companies who are prepared to take on the competition in difficult markets.

The main problem is to encourage disparate UK interests to work together to produce the same effective terms that our competitors can achieve through their institutions. Recent successes suggest that we are beginning to put our act together better, though there are still areas where we are seeking improvement.

From an overall trade perspective, the Secretary of State considers that support, through ECGD, the aid programme, or Industry Act, which enables UK companies to match the practices of our competitors is far preferable, and more likely to yield early results, than giving way to the protectionist pressures to ease adjustment for our less competitive industries.

✓ Unless it was particularly wished, the Secretary of State would not suggest an EX meeting on these papers by themselves. Through EX(0) regular reporting of major project opportunities has been set in hand, and arrangements to make the most of senior Ministerial visits. The Secretary of State is however, concerned that the ability to continue support under the aid programme for major project opportunities using ATP will be negligible next year. But this is a matter that he



From the Secretary of State

proposes to raise separately.

Copies of this letter and enclosures go to the Private Secretaries to the members of EX, to the Secretaries of State for Defence Energy, Transport and the Environment, to Sir Robert Armstrong and to Robin Ibbot.

Yours sincerely,

A handwritten signature in brown ink, appearing to read 'John Rhodes', written in a cursive style.

JOHN RHODES
Private Secretary

JAPAN

INDUSTRIAL STRUCTURE

The Japanese industrial structure is characterised by:

- (i) large industrial groupings comparable in size with the multinational companies but in most cases with more diverse interests;
- (ii) a complex, highly efficient and Government-regulated banking system closely geared to the needs of industry; and
- (iii) intense competition between companies and between banks, in a large and demanding home market with a strong preference for Japanese goods.

2 Most of the industrial groupings are involved in overseas projects. There are two kinds. The first are trading houses comprising a central sales and distribution company and major bank with between 20 to 130 associated companies. The second are industrial conglomerates of 20 to 40 mainly manufacturing companies, which may or may not be associated with a particular bank. Both kinds are loose groupings, with substantial overlaps, so that individual companies can independently pursue project opportunities, or join readily in consortium with companies from other industrial groupings, including both manufacturing and trading.

3 To give an indication of the scale of these industrial groupings, Mitsubishi, the largest trading house, had a turnover twice that of Royal Dutch Shell in 1979. Even the major constituent companies of the smaller industrial conglomerates can be larger than their UK counterparts. Matsushita Electrical Industries and Hitachi Ltd both manufacture heavy electrical plant and both have a higher turnover than GEC; the two industrial conglomerates of which they form part have turnovers twice that of GEC.

4 The effectiveness of the Japanese industrial structure may be illustrated by the performance of their firms in the power plant and desalination plant sectors. The Japanese share of the world market for power plant rose from 6% in the late 1960s to 12% by the mid-1970s and has achieved spectacular growth since. In 1979 Japanese companies took 55% of all export orders for turbine generators and 75% for large transformers. The tender for a recent power project in Australia follows a trend of reducing real costs, and could not have covered the cost of the raw materials to UK and other suppliers. Financing proposals are offered at highly attractive terms, including no payments until commissioning, any Yen exchange risk assumed by the bidder, etc. Moreover, Japanese firms can rapidly improve their financial proposals at the crucial point of negotiations.

5 A contract for a £500m desalination plant in Saudi Arabia was let to three Japanese companies. The competing UK company subsequently learnt from one of them that the business has been accepted at a 20% loss. If necessary, even lower prices would have been offered. For a subsequent smaller contract, one of the five Japanese companies involved submitted an equally low bid while the rest submitted bids comparable with those of European firms also pursuing the contract. This is one of a number of instances where the suspicion has arisen that Japanese firms have decided between themselves beforehand which one should win the contract. Historical precedent of Japanese commercial behaviour eg motorbikes, colour TV, ship-building, motor cars, etc suggests no let-up in the Japanese desire to

establish dominant market shares for new areas such as power and desalination plant, telecommunication projects, and future micro-chip production and application.

6 The industrial groupings benefit from economies of scale; extremely efficient and flexible production; large research and development programmes, with in some cases major Government involvement; a facility for cross subsidisation of temporarily unprofitable activities (Mitsubishi, for instance, covers projects and a wide range of manufactures from chemicals to electronics goods); and the resources to diversify rapidly into new and growing markets. Companies tend to have high fixed costs - apart from labour in some instances, major companies often carry the costs of housing, education and travel for their workers, which contribute to a prime objective of long-term profit through maximising market share, rather than immediate maximisation of profit on individual contracts.

7 The banking system ensures that finance is rarely a constraint on the activities of the industrial groupings. The Japanese have a high propensity to save. The banks are in strong competition in on-lending this money. The result is that industry is offered the long-term credit that it needs. Individual companies naturally look first to their main bank for finance but they are free to get the best deal they can from elsewhere in the banking system. With industrialisation being initially financed wholly by bank lending, and with a slower development of a capital market, despite bank equity in individual companies being restricted (10% currently, but due to reduce to 5% by 1986), there is generally a continuing and close working relationship between banks and the major Japanese groups.

To present a balanced picture, two recent developments which have constrained bank lending should be mentioned. First, there has been some crowding out of private sector lending by public sector borrowing to finance large budget deficits. Japanese firms have however been able to assume a higher proportion of self-financing through higher profits generated by a favourable Yen exchange rate. Second, Japanese banks have been restricted since last year to lending a maximum of 20% in relation to their capital to any one major customer. Many major banks have increased their capital or are in the process of doing so to partly overcome this constraint.

GOVERNMENT INVOLVEMENT IN INDUSTRY

8 Lacking any significant natural resources, there is effectively consensus in Japan on the need to maintain industrial pre-eminence above other objectives. Industry is usually capable of doing this unaided but when necessary there is acceptance of central planning to achieve this by, for instance, a rapid transfer of labour and capital from dying to growing industries. The Government role in implementation, usually through MITI, is opaque to outsiders but highly effective.

9 When a promising sector has been identified, the Government adopts an aggressive "infant industry" approach providing research and development funds and cheap finance to assist the sector to rationalise and develop advanced products focused from the outset to gain overseas markets. Intensive competition is promoted in the domestic market to test the results. The overseas market, usually concentrating initially on South East Asia, will then be attacked at price levels designed to establish a large market share, with a subsequent/parallel strategy to penetrate new markets, deploying a wide range of methods including manufacturing investment in developing countries to allow Japanese domestic manufacture to move to products of higher or new

technology, and investment in production facilities in the markets to be attacked.

10 This process is articulated throughout companies/sectors by a style of "consensus" which is unique, but extremely effective, flexible and opaque. It is this consensus approach which clearly distinguishes in kind as well as extent Japanese planning from that employed in Eastern Europe.

EXPORT CREDIT

11 The Export Import Bank (EXIM) and MITI offer the usual range of credit facilities within the consensus and insurance but these are less extensive than those of ECGD. EXIM also offers import development loans at 6-9% interest repayable over 7 to 20 years to countries for the purpose of gaining access to resources which Japan needs. The largest of these was to China (for coal and oil). Aid development loans have a similar purpose and in theory are unrelated to export credit lines so that the consensus does not apply. Japanese producers generally receive a higher than usual proportion of the contracts financed in these ways.

BILATERAL AID

12 The Japanese bilateral aid programme (\$2.6 billion in 1978) has been concentrated in the Far East and South East Asia but has been extended to include some Middle East and African countries. Project aid is being progressively untied, though even in these instances a Japanese consultant is often appointed which effectively gives Japanese industry an inside track. In addition to serving developmental purposes in many instances, Japanese aid is also strongly motivated by commercial objectives, and hence political objectives, since the expansion of trade is a pre-eminent objective: a comparison is that 5% of UK aid in 1978 went to countries with per capita incomes exceeding \$1,000 compared with 17% for Japan. These recipients included Iraq, Brazil and Algeria. Between them they offer an excellent mix of good commercial markets and the resources Japan needs. Commercial interest is similarly reflected in the sectoral distribution of Japanese aid. 23% was devoted to industry, mining and construction (UK 12%) and 49% for public utilities (UK 22%).

MIXED CREDIT

13 Japan claims to have only recently reintroduced mixed credits and no figures are yet available. The grant element has generally been above 25% and therefore does not require notification under the Consensus before a contract has been awarded. One exception was in 1980 when they put in a £300m bid, with a 16.7% grant element, for a railway electrification contract in Mexico. In this case ECGD had sufficient notification and were able to make a matching offer. In addition, there have been reports from India and Kenya of Japanese lines of mixed credit for telecommunications and other projects. Japanese firms receive assistance with their pre-contractual expenses for projects. There are indications that these are more widely available and more generous than those which UK firms receive. Furthermore the Japanese trading houses have an in-built capacity for counter-trade in what may be quite unrelated commodities, and this also serves to increase their competitiveness.

MARKET AND SECTOR PRIORITIES

14 The Japanese Government periodically publishes the expected sectoral priorities for future investment and trade. But whatever may be the general declared objectives, the harsh reality is very aggressive competition in power generation and desalination, metal and chemical process plant, energy developments, railways, telecommunications and applications of micro electronics. The Japanese are not of course always successful. They failed for instance to obtain a dominant share of the market for earth moving equipment, and an attempt at the civil aircraft market abroad has met with indifferent success. In some markets, eg the Far East and South East Asia (where the industrial groups are frequently well entrenched through manufacturing operations), the Japanese position is so dominant that UK and European producers will often not bother to compete; elsewhere (eg Middle East, Eastern Europe, Latin America), the Japanese effort is well established as a result of policies directed at acquiring energy and raw material supplies. In developed markets such as the EEC and the USA they tend to concentrate on achieving a high market share in a limited number of sectors, essentially - and for obvious reasons - where procurement decisions are in private hands.

(This paper generally reflects the situation in France before this year's election)

Industrial Structure

The distinctive feature of the French technique in pursuit of overseas projects goes back to the essential role played by Government in the creation of French industry in the absence of a fully effective capital market. The French Government sees the country still in the process of this industrial evolution, and accept as their objective the establishment of enterprises capable of taking on the Japanese and Germans. Some of the more pertinent aspects of this approach are:

(a) A consistent pattern of developing policies to maintain key industries, eg nuclear, aerospace, military technology, telecommunications, fast rail, etc, with capture of markets an essential part and with concentration on no more than two companies in each industry.

(b) A strong Government equity stake in banking, insurance and companies themselves: a situation complicated by central controls exercised through the prefectures and through major sectors of the financial system.

(c) A relentless emphasis upon technology acquisition, whether through Government procurement demanding technology-transfer from non-French participants, denial of market access while French products are developed, or insistence upon joint-ventures for technologically oriented inward investment.

(d) Deft use of political leverage and opportunistic drive for particular markets: military sales tactics in the Middle East, South America and South Africa are one illustration. This includes the conclusion of large civil contracts with Iraq when much-needed military deliveries were being negotiated, and the large credits recently offered to Brazil when everyone else is tightening exposure to Brazil is another. A feature of French sales policy, which applies particularly but not exclusively to arms sales, is to emphasise France's independence over the continuance of supply.

2 Of particular interest in the projects industry are 13 consultancy firms, known as SOFRES, which are closely connected with important public sector bodies and cover the main project sectors. This public sector link allows subsidised financing, and the SOFRES admit that, wherever possible they specify French equipment. French private sector consultants also adopt a similar attitude.

3 Another illustration lies in Technip, largely owned by the two state-owned oil companies, and offering design engineering and general contracting for projects overseas. In 1979 they won turnkey contracts worth £108m; as with the SOFRES, post-tax profits are usually less than 1%. They have recently instituted a scheme of free engineering consultancies and claim to have gained a foothold in Brazil by doing this. It has also been reported that the Mitterand Government has it in mind to increase the French bilateral aid programme.

Government Involvement

(a) Subsidised Credit

4 Credit at subsidised rates is pervasive in the French economy. In 1979/80, 44% of all loans and credits were subsidised, with Government or semi-public institutions (regional banks, etc) providing over half this (and this figure has now included tax reliefs or direct Government subsidies as opposed to loans). There has been a steady increase in the proportion of subsidised

loans since 1974 following the introduction of new subsidies to encourage exports or investments. In 1979/80, 78% of loans to exporting companies were subsidised. The value of the subsidised loans was about £5 billion.

(b) Export Credit and Insurance

5 In France there is no single entity which performs the functions of our own ECGD but a similar range of facilities is provided through credit insurers (COFACE) and Government sources (DREE, Banque de France, Trésor). In 1979/80 COFACE report that their facilities alone cost some £400m, about the same as ECGD's: this appears to be a very conservative figure, since cost escalation cover alone cost the French Government about £280m, while ECGD made a profit of about £6m on their cost escalation cover scheme. A recent OECD study of Consensus participants estimated that French interest rate subsidies for 1980 were about £1,000m. This was much the highest figure and was more than double that estimated by OECD for the UK. More generally, although the total value of French and UK exports is broadly comparable, for the two years 1977-78, French officially supported export credits on terms over five years (excluding aircraft and ships) totalled more than twice those of the UK, suggesting a heavy concentration on projects.

6 Some arrangements to act as lender of last resort when French firms have to accept onerous terms seems possible, for example, in September 1980 Plessey lost to Thomson-CSF a £400m contract for an electronics complex in Iraq. A key aspect was a performance bond of some £80m, which Thomson accepted (but which was unacceptable to Plessey) despite Thomson's relatively stretched balance sheet.

(c) Aid and Mixed Credit

7 France's aid total is high: £1.6 billion in 1979 (West German £1.6 billion, UK £1.0 billion), 40% of which went to her overseas territories and departments. Fully tied bilateral aid accounted for £730m of total aid (West Germany £253m, UK £420m), 90% of which went to Francophone countries, largely on grant terms.

8 Besides having a much larger aid budget, the French mixed credit programme is far more extensive than the UK's. French mixed credits notified in 1980 were £1,120m (compared with £580m in 1979). The aid portion of this was £350m compared with only about £70m from the UK. The French are aggressive users of mixed credits and have little hesitation in initiating. It is also difficult to know whether there is a firm French offer to match, since although they may tell the client informally that aid will be provided, the precise terms of mixed packages are rarely notified until after the contract has been won.

9 The covert use of tied aid by the French is made more difficult to combat by their use of established lines of credit to part or wholly finance capital projects. The French typically open a line of credit to finance a project or the purchase of equipment which may be of relatively low cost. The line is then extended or further, major, projects included. During 1980 alone, the French notified us of 12 lines of mixed credit (worth £413m, aid portion £160m) open to 11 countries. By contrast, the UK recently opened its first line of mixed credit, with Malaysia for £77m; the grant element is over 25% and therefore the Consensus does not require its use to be notified before a contract is awarded. One notable recipient of French lines of credit is Brazil. The French have offered in excess of £600m since May 1980 in soft credit with an overall grant element of only about 15.2% which under the Consensus requires notifications as soon as it is offered for a contract. Some of the projects included concern hydro-electric power, railways and airport development. (By contrast, the limit for ECGD's Section 2 account for Brazil has recently been fixed at £1,250m - as a prelude to the signing in October of a Memorandum of Understanding covering large projects in Brazil).

10 In Mexico, the French have recently operated two lines of mixed credit simultaneously, particularly for railway projects. In 1978, they used one to scoop the contracts, in excess of £150m, for the extension of Mexico City Metro. Although this did not fully use up the first line, a second, for £100m, was opened by President Giscard during his visit in March 1979. COFACE did not notify ECGD of this line until September 1979, thus contravening the Consensus. When French and UK firms were bidding for a further £100m contract in early 1980, ECGD had considerable difficulty obtaining an answer from COFACE as to whether one of the lines would be used. In the event, we made a matching offer despite the French prevarication, and COFACE only confirmed later that their first line of mixed credit was being made available.

(d) Pre-contractual Expenses

11 The French have several means of assisting firms with pre-contractual expenses. Although we do not have comprehensive figures, reports from UK firms indicate that they are at least as generous as the Overseas Projects Fund 1981 (budget £m 5.75 pa) and, unlike the Fund, do not require repayment if a contract is won. In addition, we know that project consultants have offered free feasibility studies normally costing up to £50,000.

(e) Ministerial Visits

12 M Giscard's Minister for Foreign Trade generally spent about half the year abroad on trade promotion ventures. Of particular interest is the fact that he prepared the ground for Presidential visits by making a visit to the country about 4 to 6 weeks ahead so as to prepare texts for signature. These texts often included agreements relating to specific projects or framework agreements which are the prelude to specific agreements. While this is impressive itself, it can only be possible if the projects concerned have been earmarked well in advance for final agreement during the Presidential visits. One example of this was the President's visit to Mexico in March 1979 when the line of credit was agreed.

(f) Military Aid

13 The French have a military aid programme which is much more substantial than HMG's and is used very effectively. The French recently used it to pre-empt the Sudanese market with about £15m of free artillery equipment under a line of credit arising from President Giscard's visit there in 1979.

Market Sector Priorities

14 Two main factors determine French priorities: the need to secure raw materials supply, particularly oil, and the pursuit of markets for priority industrial sectors. Once these have been taken into account, the informal control exercised by the Government over major enterprises combined with the freedom of the Government to pick firms from amongst the limited number available in each sector to be flag bearers, enables the French to pursue projects in an impressively single-minded way.

15 Resource diplomacy explains the priority treatment accorded to Mexico, Brazil and the Gulf States. It is in these areas that French tactics have caused most concern to UK firms. The French can also be expected to preserve what they regard as their traditional project markets - the Francophone and Eastern European countries.

16 As regards sectors, it can be expected that projects involving the six priority sectors in the VIII National Plan will be given prominence. These cover aerospace and the full range of information technology. The French

have also been concentrating on railways, non-ferrous plant and, particularly in the Middle East and South America all aspects of power generation.

GERMANY

Germany industry as a whole benefits from low inflation and good labour relations. Despite generous Government aids to R&D, the percentages of GNP devoted by Germany and the UK to investment in both R&D and manufacturing industry generally have been broadly comparable. The crucial difference lies in the relative increase in net output per unit of investment, with Germany's almost twice that of the UK. Between 1973 and 1978, the average annual percentage increase in productivity (volume of output per employee) in manufacturing industry was 2.4% in Germany against 0.8% in the UK. These basic features have underpinned German industry's ability to offer very good value in terms of product technology and price, despite a strong currency for the recent past (in the immediate post-war years by contrast there was a period when the Deutschmark was held down in value) though with an advantage in their interest rates.

2 Germany has a social, rather than a free, market economy. The Government sees its job as maintaining competition and stability within the economy and to assist the structural adjustment of the economy to changing demands. This assistance cost the Federal and Land Governments in excess of £2.5 billion in subsidies to industry in 1978. German industry also benefits from the most effective "non-tariff barriers" in Europe, DIN standards. Thus the French for example have made several hundred applications in the past few years for particular French standards to be recognised as equivalent to DIN, but so far not even one has been approved. In addition, there are some striking contributory features of industrial structure and the role of Government which should be recognised.

Industrial Structure

3 The large German banks account between them for just 7% of the share capital of all German publicly quoted companies, and yet they are by far the most important controllers of major companies through shareholdings. The banks derive their power by combining shareholdings on their own accounts and holdings on behalf of their clients placed on deposit with the banks and carrying proxy voting powers. The banks are the sole stockbrokers in West Germany and can buy and sell shares on both their own account and on behalf of their clients. Although concern at the level of banks' holdings has increased, they do not publish a full and detailed list of all their holdings, and their shareholding authority when proxy votes are taken into account cannot readily be ascertained. This relationship with companies, begun through the lack of a developed capital market with the growth of German industry restarted after the First World War, remains close: the German "composite" banks thus fulfil within their capabilities the functions of the clearers, merchant banks, and, to a large extent, the institutional shareholdings. By virtue of this multiplicity of interest, major German companies enjoy a consistency and unity of support from the financing sector which enhances their competitive versatility and tolerance of risk.

4 The Federal Government has major shareholdings in a considerable number of assorted types of companies. The State owns, for example, 40% of the holding company Veba AG which is the third largest European company by turnover with interests in chemicals, electricity and transport. A more noteworthy feature, however, is that the Länder have major industrial holdings, some of which are controlled directly and others of which are controlled by the local state banks (Landesbanken). This close involvement of the state at the regional level with banks and companies is a special feature of the German economy, and its significance derives from the strong autonomy of the Länder, who, for example, have effectively unimpeded authority to dispose of 40% of all tax revenues. The Landesbanken typically provide 50% of the commercial finance for overseas projects, eg a recent report instances

a coal gasification plant being built in Mexico, with a total cost of \$120m, \$100 million of which was put up by the North West Rhine and Westphalia Government, and the remaining \$20 million by Lurgi. Combined with the power and shareholder involvement of the banks, the total financing environment provides a highly effective means of promoting economic aims and channelling Government (Federal and Länder) support, adding up to a flexible and opaque structure of assistance to industry. Finally, German industry is well supported by its Chambers of Commerce which help to focus industrial market effort and which benefit from a statutory levy.

5 German project firms, particularly in heavy engineering, are generally bigger than those in the UK. Siemens and AEG-Telefunken (electrical engineering contractors and manufacturers) had 1979 turnovers of £6.7 billion and £3.4 billion compared with GEC's £2.5 billion. German project firms sometimes form part of conglomerates. Thus Mannesman (pipe mills and steel processing firm) includes Demag, and Metallgesellschaft (non-ferrous metal plant) includes Lurgi; their 1979 turnovers were £3.0 billion and £1.9 billion respectively compared with BSC's £1.5 billion and Davy Corporation's £0.6 billion

Government Involvement

(a) Export Credit and Insurance

6 This is made available through two Government-backed private companies (Hermes and AKA) and one public company (KfW). AKA and KfW are both able to provide a limited amount of domestic finance for projects at slightly below market rates. German exporters and their banks carry a higher risk factor than their French, Japanese or UK competitors. In 1980, German officially supported export credits covered only 14% of total exports (UK 35%), but cost \$2.5 billion (UK £1.2 billion), implying a much greater concentration than in the UK.

(b) Aid

7 The German aid budget, while lower as a percentage of GNP is substantially larger in money terms than the UK's: in 1979, disbursements were £1.6 billion compared to £1.0 billion for the UK. Government policy is to increase the aid budget at a rate of at least double that of Federal expenditure as a whole in the period to 1983. Germany formally ties a smaller proportion of its aid than its major competitors, but this has to be seen against the fact that specifications in DIN narrow the scope of compliance in favour of German companies. Otherwise, their formal criteria for aid cover the span of developmental and commercial considerations.

8 While political reasons are a major factor in determining the direction of German aid expenditure, the exploitation and safeguarding of raw material supplies is very important. There is also evidence that the Germans systematically subsidise particular industries from their aid programme. For example, projects above a certain size are examined by a group comprising representatives of the industry concerned, including the trade unions, which decides where aid can be used most effectively. Also, in 1976 part of the aid budget was earmarked for purchases from the German shipbuilding industry. In 1978 this was broadened to include measures which are "also of structural, employment generating and conjunctural benefit" to the domestic economy; overseas projects could be included in this. The ceiling for this special allocation was 15% of aid commitments in 1978: about £120 million.

(c) Mixed Credits

9 While German aid disbursements in 1979 were less than twice the UK's, their offers of mixed credits (£260m) amounted to more than three times the

UK's (est. £80m). In 1980, however, the UK for the first time reversed this position with £230m in offers of mixed credit to Germany's £80m. German use of mixed credit seems to be mainly directed towards capital goods sales to developing countries and securing supplies of raw materials. German mixed credits generally have a grant element only marginally above 25%; there is then no Consensus requirement for prior notification. (An example was in 1979 when Siemens won the main Tunis urban railway contract worth some £90m with a financial package with a 24.3% grant element). They usually agree to mixed credits with a 15-25% grant element only in order to match.

10 An unusual source of mixed credit can be made available through the German Bank for Reconstruction and Development (KfW). Normally, KfW provides export credit by borrowing on the capital market and on-lending at fixed commercial rates, without any official subsidy. However, they can blend such borrowing with funds advanced from the European Recovery Plan. This Plan formed part of the US investment programme after the Second World War and is administered jointly by the Federal Government and the German States. Its annual budget is equivalent to about £50m and it lends at a fixed interest rate of 4.5%.

(d) Military Aid

11 The Germans have been giving considerable military aid to Greece and Turkey for more than 10 years. This recently cost Vickers one substantial tank contract in Greece. Following NATO pressure, Germany made about £150m available to Turkey in 1980 for the purchase of Leopard tanks. For 1981 the budget is about £18m for Greece and £30m for Turkey. Other countries have also received German military aid. In 1979 for example it enabled Lursenwerft to undercut Vospers for the sale of four fast patrol boats in Kuwait.

(e) DEG

12 The German Investment Development Company (DEG) is a Government owned corporation established in 1962 to promote investment by German companies in developing countries. It is similar to the Commonwealth Development Corporation but places a much greater emphasis on industrial projects. In 1978, DEG's new commitments were £28m. This money is being increasingly used to give German industry a larger share of overseas mining projects. One example of their work was the announcement in December 1980 that they would help to set up six joint ventures in the Philippines in areas including engine manufacture, chemical plant, mining and telephone equipment manufacture.

13 In conjunction with this use of the DEG, the Government has further promoted investment in developing countries through a number of substantial tax incentives. These have enabled parent companies in Germany to defer for five years tax on any profits reinvested overseas. DEG money is also being increasingly used to give German industry a larger share of overseas mining projects. There is a special Government subsidy for mining exploration costs of up to about £15m in 1981 which is repayable if the results lead to investment.

Market and Sector Priorities

14 Although Germany has extensive coal deposits, the Government is concerned, like the Japanese and French, to secure supplies of raw materials, including oil. This largely explains the relative concentration of export promotion facilities and aid on South America, the Middle East and the USSR (gas supplies). They also attach priority to Turkey and North Africa.

15 As regards sectors, the Germans concentrate on all aspects of heavy engineering. They are very strong in the supply of railway equipment. The Government believes a growth area of particular significance will be energy saving equipment. There is also evidence that the Government attaches importance to steel plant and power generation projects.

USA

The main characteristics of the US projects industry derive from:

- (a) A very large home market, with a disposition to order from domestic industry;
- (b) The existence of major contracting enterprises such as Bechtel and Fluor, who by virtue of a strong home base, often working for public utilities in some of the functions carried out by nationalised industries, have developed considerable financial strength;
- (c) Large and well-diversified manufacturing companies, with well-established links to the main contractor/management companies;
- (d) Apart from such links established through their internal market, in many export markets with a history of UK political involvement, local requirements tend to be couched in specifications favouring US suppliers.

2 The US Government, while formally eschewing specific support to companies for export projects, nonetheless is a past master at using political clout and the leverage of civil/military aid, to establish a presence for US exporters for major projects. In addition, where there have been major and massive federal programmes, whether space, defence or civil (such as the Federal Aviation Authority), their manufacturers inevitably have a major advantage. They are arch lobbyists in fora which are decisive to future international standards eg ICAO (where they have consistently won in competition for adopted designs - most recently for blind landing at Plessey's expense) and NATO.

3 Consequently, where large scale and advanced technology are dominant, US firms are very strong competitors. By value of contracts won by constructing companies in 1979, US firms occupy first, third, fourth and sixth places in the world. The largest, Fluor, won \$4.4 billion on this basis compared with the \$2.1 billion won by Davy, its main UK rival and fifth in world ranking. An important structural difference is the capability of such US firms to provide the complete range of design, management and finance services required for large projects.

4 The sectors in which the American project industry is especially strong include process plant (especially oil refineries), telecommunications (especially those involving satellites), airports, power generation and railways. The market priorities and performance of US project firms are to a considerable extent influenced by American foreign policy. US firms won substantial project business in the Middle East (especially Saudi Arabia) in 1979 (at 17% of the total, only slightly less than Japan) but the value of contracts fell by a third in 1980, reflecting in part changes in American foreign policy in the region. Similarly, there are special embargo prohibitions on the sale of high technology to the USSR, Cuba, etc which inhibit their companies from some categories of capital projects. Finally it should be mentioned that the US projects industry is critical of the support it receives from Government and of restrictive legislation. If some of these disincentives to export were removed the industry would become an even more effective competitor.

5 There is a system in the USA under which a domestic manufacturer can establish a wholly owned subsidiary for the exclusive purpose of exporting known as a domestic international sales corporation (DISC). Such corporations enjoy deferral of corporation income tax, and the net effect is to reduce tax on profits by some 25%. In 1978 the Administration announced the intention of phasing out the DISCs system, but this was not accepted by Congress and no further action has been taken. There is evidence that this system is an effective export subsidy, and it continues to be strongly criticised in the GATT by the Community and others on these grounds.

6 US firms in Saudi Arabia benefit considerably from the unique role played by the US Army Corps of Engineers to plan, commission designs, evaluate bids and award construction contracts for armed forces instalment on behalf of the Saudi authorities. Projects completed under the Corps's supervision have cost £470 million, £3,000 million are at the proposal or design stage. The Corps handles this work as the main contractor and receives payment in advance, thus avoiding the cost and risks involved in payment by instalment. Design and engineering work is contracted exclusively to US firms and although construction work is put out to international tender, US firms clearly benefit from the prior involvement of the Corps and US consultants. There are indications that the Corps is establishing a similar position in Oman.

7 The Export Import Bank (EXIM) provides direct financing, normally up to 55% of the contracts but occasionally for 100%, and insurance to the project industry. There is a tendency to deploy extended duration of loans as a mechanism for winning business, but exchange risk and cost escalation cover are not available. The US Government is a strong advocate of the Consensus, and hence adopts an aggressive attitude against mixed credits. The US have declared their intention to match French offers of mixed credit through EXIM long-term soft finance. This helped them win a £30 million locomotive contract in Mexico earlier this year against French, UK and Japanese competition. Although the US maintains a substantial aid programme, its objectives seem to be predominantly political, and the general pattern of bilateral aid is determined by internal US pressures. Financial assistance towards the pre-contractual expenses of US firms is available on lines similar to that provided by DoT.

8 The original Reagan proposals for EXIM implied a 31% reduction in loans for 1982/83. But there have been indications that, in response to strong corporate pressure, this kind of dramatic cut-back may not be implemented. It is moreover, the view of our Embassy in Washington that the original EXIM proposals are more vulnerable to amendment by Congress than most. The industry's export prospects may therefore not be significantly affected. The proposals for the aid programme in 1982/83 on the other hand are for a \$200 million increase. As indicated above the US projects industry is unlikely to be a major beneficiary, but there are also indications that the Americans will shift the balance towards more bilateral and less multilateral aid which might work to the advantage of the industry.

Trade



Treasury Chambers, Parliament Street, SW1P 3AG

01-233 3000

9 November 1981

The Rt Hon John Biffen MP
Secretary of State for Trade
Department of Trade
1 Victoria Street
LONDON SW1

NBPA

[Handwritten initials]

[Handwritten signature: Sir John]

REVISION OF COMMUNITY REGULATIONS ON IMPORT CONTROLS

I have seen a copy of your letter of 30 October to Peter Carrington, and Humphrey Atkins' reply of 4 November. ^{on previous point}

I very much agree with you on the importance of retaining an effective right of national action. This was the conclusion reached, as you say, at the Prime Minister's meeting on 8 September.

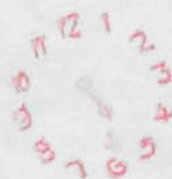
As to the Commission's proposals for new import Regulations, I agree that we cannot accept that controls would have to be lifted immediately if the Commission did not approve them. I therefore support the line proposed in paragraph 6 of your letter.

Copies of this letter go to the Prime Minister, other members of OD(E), Patrick Jenkin and Sir Robert Armstrong.

[Handwritten signature: Geoffrey Howe]

GEOFFREY HOWE

-9 NOV 1981





10 DOWNING STREET

PRIME MINISTER

DUAL PRICING OF CARS

Here is a letter from Patrick Jenkin to John Biffen, written after the two Ministers had seen advance copies of the "Which?" inquiry published today.

The attached memorandum is written very much from an Industry viewpoint. The crux of the argument is contained in the final two paragraphs - 12 and 13. You might like to glance at these before you look at the body of the argument - otherwise, I fear that your reaction will be that the Department protests too much.



MA

6 November 1981

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DEPARTMENT OF INDUSTRY
ASHDOWN HOUSE
123 Victoria Street
London SW1E 6RB

Telephone

Direct Line: 01-212 3301
Switchboard: 01-212 7676

6. 11. 1981

Mike Pattison

I hope this covers what
you asked for.

With the Compliments of the
Private Secretary to the
Secretary of State for
Industry

Jan Ellison



DEPARTMENT OF INDUSTRY
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Secretary of State for Industry

5 November 1981

The Rt Hon John Biffen MP
 Secretary of State for Trade
 Department of Trade
 1 Victoria Street
 London SW1

Dear John,

I have recently received from the Consumers' Association a copy of their forthcoming "Report on Car Prices and on the Private Import of Cars in the EEC Countries". I see from the Consumers' Association's letter to you that they believe that "there is something wrong with the structure of the British market" and that they ask what steps we propose to take on the car price differential.

2 Although I have some sympathy for the Consumers' Association's desire to take action on what they see as an abuse of market power, I do feel that their view that the current situation does in fact reflect an abuse is based on a misunderstanding of the economics of what is happening. I attach a note prepared by economists here setting out our analysis of the car market, and highlighting the important role played by the strength and volatility of the exchange rate. British producers have to price competitively in continental markets if they wish to retain a presence - even if this means, as it currently does, that they are selling at a fully accounted loss. Because of the volatility of the sterling exchange rate, foreign producers are at the moment unwilling to try to capture a larger share of the UK market by reducing their prices. With the substantial financial commitment that this would entail for enlargement of their dealer networks and for advertising, the volatility of the exchange rate simply makes the risk too high. If the exchange rate does, however, settle down at a relatively high level, which the market perceives to be viable and sustainable, then we would expect foreign manufacturers to take a much more aggressive attitude on pricing in the UK.

3 None of this is evidence of anti-competitive practices - indeed the market for cars is fiercely competitive. It is quite clear to me that to interpret the current car price differential as an abuse of market power is to misunderstand the economics of



this market.

4 Nevertheless, it is clear from the thrust of the Consumers' Association's letter that they are hoping for a request from you to the Director General of Fair Trading to investigate car pricing. I can appreciate that you might also feel that it would be useful in clearing the air by demonstrating that there is, in fact, no evidence of any abuse of market power in this market. But we should recognise that these reasons for asking the Office of Fair Trading to undertake an investigation would be largely cosmetic. The possible effects of such an investigation could be most serious to the financial health of UK car producers at a critical time. If an OFT investigation were threatened, companies such as Renault and VW importing cars into the UK would almost certainly try to pre-empt OFT by reducing their prices in the UK - which they are relatively well placed to do, given the strength of sterling against the franc and the DM. Ford and BL would have to follow suit and the effect on BL in particular would be extremely grave. Officials here estimate that an early reduction of BL's current average price premium of about 25% to around 15% would double the company's trading losses in 1982 and wipe out its forecast trading profit in 1983. The figuring is inevitably crude, but the message is clear: financial effects of this order would be sufficient to reverse the slim chance BL has of returning to viability. I do not think we should get ourselves into a position where our objective of reshaping BL and returning it to the private sector is put at risk by an enquiry by the Office of Fair Trading and accordingly urge you most strongly to resist consumer pressure on this issue.

5 I am sending copies of this letter to the Chancellor of the Exchequer and the Director General of Fair Trading, both of whom have received advance copies of the Consumers' Association report.

Your ave
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WHY ARE CAR PRICES CURRENTLY HIGHER IN THE UK?

1. The current differences in the selling prices of new cars in the UK and other European countries are due to a number of factors, among which are different tax arrangements and differences in the profit margins taken by distributors and dealers. But by far the most important consideration is the level of, and movements in the real exchange rate. In reporting on its European price survey the Consumers' Association (CA) has - rightly - abstracted from tax differences. But it has failed to take into account how exchange rate changes affect the price differentials. This is a crucial omission.

CURRENT PRICE DIFFERENTIALS

2. As the CA report shows, car prices in the UK are currently considerably higher than they are in Europe. The only company for which we have detailed information - BL - estimates that the differential between its UK prices and the average across the European sales territories is currently around 25%. Our understanding is that other car manufacturers have a similar differential at present.

3. All the major producers of cars sell at higher net-of-tax list prices in the UK than they do elsewhere in Europe. It is therefore not correct to see car price differentials as being somehow peculiar to BL (as some recent press comment has done). In fact, the price leader in the UK volume car market is Ford. Despite pricing at something of a premium in the UK, Ford have - in large part because of their comprehensive and excellent range



of cars which meets in particular the needs of the fleet market - managed to retain a market share of around 30% (as compared with BL's current share of around 20%). BL tends to follow Ford's lead on pricing, at least in timing terms, although it does not put up its prices pari passu with Ford's: since 1976, BL's volume car prices have risen by about 18%, while Ford's have risen by about 28%.

CHANGES IN PRICE DIFFERENTIALS OVER TIME

4. Prices in the UK have not always been higher than they are in Europe. This is illustrated by the following table, which shows the average UK price of a composite of key models of BL, Renault, Volkswagen and Mercedes divided by the European prices of the same models (so that a figure less than 100 means European prices higher than UK prices).

	<u>1975</u>	<u>1976</u>	<u>1977</u>	<u>1978</u>	<u>1979</u>	<u>1980</u>	<u>1981</u>
UK price/ European price (January)	101	110	96	112	106	108	154
Real exchange rate (Q1 1975 = 100)	97	102	88	97	103	131	156

This table shows that car prices in the UK have only recently become spectacularly higher than they are in Europe; that relative prices are extremely volatile; and that there is a marked correlation between the movements in the price differential and changes in the real exchange rate - ie the nominal effective exchange rate adjusted for differences in national cost inflation. Indeed the table shows that the development of the price



differential can be wholly explained by the increase in the real sterling exchange rate. The differential is therefore the result of general economic developments rather than the result either of shortcomings particular to the UK motor industry or of collusion and anti-competitive practices by the world's motor manufacturers.

INFLUENCE OF THE EXCHANGE RATE

5. In the longer term, we would expect relative prices to reflect underlying real exchange rates (ie taking into account different inflation rates, as well as 'nominal' exchange rates). But in the short term manufacturers in this industry, as in other competitive industries, price to reflect their position in markets at any given time. UK producers have relatively small shares of European markets, and have therefore relatively little ability to influence pricing in these markets.

6. The exchange rate interacts with pricing decisions to determine what margin the company ultimately receives on its sales. For example, an importer into the UK may choose during a period when the £ is rising to keep his margin constant and cut his £ price; or he may choose to take the stronger sterling effect in the form of a higher margin.

7. From the consumer's point of view, exchange rate changes unmatched by changes in local currency prices can make sharp and appreciable differences in the price of a new vehicle to him. A numerical example may help. Suppose a BL vehicle cost £5,000 in the UK. BL decides to price at the same level in France. At an exchange rate of £1=10Fr, the car costs Fr 50,000. Now suppose the exchange rate strengthens to £1=12Fr. If BL holds its local currency price the car that costs £5,000



in the UK now costs around £4,200 if brought in France.

8. The key assumption in this is obviously that BL holds its foreign currency price constant. And the force of the argument above about how UK producers have to follow the market when they sell into Europe, is this: that a company such as BL or Ford may, given its market power in a particular country, simply not be able to increase its local currency price in line with the strength of sterling. In the short-term these companies have no alternative but to follow local currency prices ruling if they wish to maintain a presence in the markets. This may mean that for some periods, as at present, they are selling at a fully accounted loss. In the longer term they will either have to improve their relative competitiveness or withdraw from the markets. This is part of what we have seen reflected in BL's financial results this year and last: very low or non-existent margins on European sales.

VOLATILITY OF THE EXCHANGE RATE

9. It follows from all this that the interaction of exchange rate and companies' market power may lead to their incurring losses in particular markets. Clearly this is not a situation that can persist indefinitely. (BL for example have withdrawn from the sports car market because of their inability to reflect exchange rate changes in their pricing). But, as we know, companies do carry on for considerable periods in markets where they are making fully-accounted losses. The reason for this in the context of the car market is volatility of sterling.



10. Turning to the foreign manufacturers, the question to be answered is why the manufacturers have raised their margins in the UK rather than reduced their UK prices in sterling in an attempt to take a larger share of the market. The answer lies in the volatility of the sterling exchange rate and the uncertainty with which the manufacturers view the future developments of sterling. The uncertainty arises because, historically, exchange rates over time have usually reflected developments in a country's average competitiveness. This has clearly not been so in the UK over the past four years (as the table above shows) which gives rise to questions whether sterling will fall to reflect the underlying UK competitive position. This questioning is supported by the extreme volatility of sterling.

11. That sterling is volatile is strikingly illustrated by a calculation - again by BL - that their UK prices last May were about 45% higher than their European prices. As already noted, the differential is now around 25% - a fall of nearly one-half over a period of 4 months. Over the same period the effective exchange rate has moved from 99 to 87.3. This change in the exchange rates therefore largely accounts for the fall in the price differential. (This also has a bearing on the interpretation of the results in the CA report which is based on a survey carried out in June). The volatility of sterling, and its enormous impact on the differential, explains not only why companies try to hang on in markets where they are making losses but also why importers into the UK have, this year at any rate, been content to take the impact of sterling's strength on their margins rather than holding prices and trying to gain market share. Market share in the car industry cannot simply be got by reducing local currency prices. Market share has to be 'bought' by eg investment in strengthening



the dealer network. These are long-term investments whose return depends on the ability to maintain the increased market here in future years. With exchange rates as volatile as they are and perhaps a belief that the strength sterling in real terms cannot continue, foreign manufacturers have obviously enough been (so far) reluctant to make this investment. This attitude has been strengthened by the fact that most European car manufacturers are in more or less serious financial difficulty.

A COMPETITIVE MARKET

12. The thrust of all this is that the current car price differential is explicable entirely in terms of companies' financial and market circumstances interacting with exchange rates. It does not reflect anti-competitive practices or collusion: on the contrary, the car market is one of the most fiercely competitive there is. The view that the car price differential reflects some form of abuse of competitive position on the part of manufacturers rests on a complete misunderstanding of the economics of what is happening.

13. This particular misunderstanding is, however, a very widespread one. There is considerable consumer pressure for the Government - or somebody - to take some form of action to reduce the differential. It is conceivable that, if this pressure were maintained, those manufacturers who can best afford it - the importers - would take the decision to reduce their prices somewhat in the UK, for ^{presentational} reasons. If this were so, BL and Ford would have to follow suit - with extremely damaging financial consequences for BL.

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CONFIDENTIAL



Trade

Foreign and Commonwealth Office
London SW1

4 November 1981

Mr Saffron
NRPA

Hand 5/11

Dear John,

REVISION OF COMMUNITY REGULATIONS ON IMPORT CONTROLS

Thank you for your letter of 30 October to Peter Carrington.

I entirely understand your wish to retain credible powers to take national action and I agree that we must do all we can to ensure a satisfactory system. As you point out, Member States' present powers will in any case automatically be considerably reduced at the end of this year. Only the Commission can propose substitute arrangements and I agree that the proposals they have put forward are not satisfactory as they stand, since they would in practice even further reduce the scope for Member State action beyond the position which would otherwise apply automatically after 1 January.

But given the Commission's key position, I think we have to recognise that in their view, Member States cannot expect both to retain freedom to take independent action and at the same time to benefit from the fact that it is the Community as a whole which has to bear the consequences of that action, since under GATT rules supplier countries affected are entitled to seek compensation from, or to retaliate against, the Community as a whole and not just the individual Member State concerned. (In the US synthetic fibres case, for example, the Americans obtained compensation in the form of tariff cuts on US chemicals imported into all parts of the Community, not just the UK.)

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The Rt Hon John Biffen MP
Secretary of State for Trade
1 Victoria Street
London SW1

CONFIDENTIAL



It should also be pointed out that safeguard action is rare (only one instance in the whole Community - on US synthetic fibres, at UK instigation - during the three years that the present regulation has been in force). This is not because of Community rules but because, under the GATT, safeguard action can carry heavy penalties in the shape of retaliation. And during the same period there has been no case at all of unilateral action by a Member State - indeed from 1977 to 1979 Member States lost all power to take unilateral action when the previous regulation lapsed and it proved impossible to agree on a successor. I realise the pressures are stronger now than they were three years ago (not least as regards Japan, about which I am writing separately) but the past history rather suggests that the right to take national action is of less practical importance than it may seem.

You ask whether it might be possible to use our Presidency to secure retention of the status quo by persuading the Commission to come forward with a proposal to this effect. The fact is that, as guardians of the treaty and the common commercial policy, the Commission are strongly attached to their present proposal and would regard as anathema any idea that they should put forward a proposal to maintain a situation which they believe should have ended years ago. I therefore do not think it would be realistic to suggest this to them and merely doing so might well prejudice our efforts to improve their present proposals as well as wasting much valuable time.

Against this background the 'compromise' proposed by your officials and referred to in paragraph 6 of your letter seems to me ingenious. Your officials point out that the Commission proposal as it stands could lead to a Member State being required to remove a restriction pending an investigation which might well result in its subsequent reimposition. As they say, this is quite illogical. They suggest that we should seize on this illogicality and argue in favour of Member States having the right to maintain restrictions until the investigation procedure is completed (ie for a period of some months).

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This would of course represent a considerable strengthening of our right to take unilateral action for the category of products at present subject to the weaker of the two sets of rules. At the same time we could still appear in Community terms to be taking a constructive and moderate line, consistent with our Presidency position. For all these reasons I therefore favour this course.

Like you, I am reluctant to contemplate a fall back position at the present stage, though the possibility outlined in your paragraph 7 is something that we may have to consider in the last resort. This would however be no more than a temporary arrangement while efforts to find a definitive solution continued under the Belgian Presidency.

I am sending copies of this letter to the Prime Minister, to other members of OD(E), to Patrick Jenkin, and to Sir R Armstrong.

Yours ever

W. Whitely

15 NOV 1981

11 12 1 2 3
9 8 7 6 5 4

PART 1 ends:-

30.10.81

PART 2 begins:-

4.11.81

