PREM 19/1987

Export Credits Guarantee Department (ECGD)

Cost Escalation Cover Scheme. Financial Strain on the Department.

Revised ECGD Status PART 1

TRADE

PT1:
January 1980

PREM 19/1987

Referred to	Date	Referred to	Date	Referred to	Date	Referred to	Date
23.1.80		13.7.84		15.5.86			
[illegible]		1.10.84		23.5.86			
21.3.80		15.10.84		PT 1 ENDS			
[illegible]		26.10.84					
12.1.82		1.11.84					
[illegible]		8.11.84					
5.11.82		15.4.85					
2.7.83		16.4.85					
2.11.83		29.4.85					
7.11.83		1.5.85					
8.11.83		8.5.85					
16.11.83		16.5.85					
10.11.83		11.6.85					
[illegible]		16.7.85					
13.12.83		24.7.85					
2.4.84		30.7.85					
6.4.84		4/11/85					
26.5.84		10.3.86					
8.6.84		24.3.86					
		27.3.86					
		4.4.86					
		28.4.86					

Od 533270 5M 2/78 8362633 JET

SECRET

PART ONE ends:-

PM to MINISTERS (M8/86) 23/5

PART TWO begins:-

DOE to MGA 9/6/86

TO BE RETAINED AS TOP ENCLOSURE

Cabinet / Cabinet Committee Documents

Reference	Date
E(EA)(80)5	21/01/1980
E(EA)(80) 3rd meeting, item 1	23/01/1980
E(A)(85)47	15/07/1985
E(A)(85)46	12/07/1985

The documents listed above, which were enclosed on this file, have been removed and destroyed. Such documents are the responsibility of the Cabinet Office. When released they are available in the appropriate **CAB** (CABINET OFFICE) CLASSES

Signed _____ Date 21/05/2014

PREM Records Team

Subject cc ops
Master

File

LO

10 DOWNING STREET

THE PRIME MINISTER

Personal Minute

No. M8/86

TO MINISTERS IN CHARGE OF DEPARTMENTS

CONTINGENT LIABILITIES

The recent collapse of the International Tin Agreement, leaving a massive deficit on its operations, has been a sharp reminder of the importance of guarding against commitments carrying a risk of imposing contingent liabilities on government in later years.

The guidance to departments on this subject has recently been tightened up by the Treasury and reissued in the new edition of "Government Accounting" and I trust that it will be closely observed. There are two points in particular which I should like to stress.

The first is that there needs to be a most careful and thorough appraisal of the risks, including the legal aspects, before any contingent liability is accepted. The only sure control over contingent liabilities is not to assume them in the first place. Particular vigilance should be exercised in the case of non-statutory assurances which may be construed as placing a financial obligation, moral or legal, on the government.

The second is the need to keep a careful watch on those contingent liabilities which have already been assumed. Any payment arising from a maturing liability will place a burden on the expenditure programme of the department responsible

PA

for the activity in question. As well as complying with the formal reporting arrangements, departments need regularly to look at all their outstanding contingent liabilities and consider whether all available steps are being taken to minimise the risk of a payment being required, or its amount. This review should cover contingent liabilities arising both from the department's activities and from those of public sector bodies which it sponsors. It must not be assumed that the Reserve is available to protect any department from the consequences of failing to exercise this vigilance.

I ask all Ministers in charge of departments to take a personal interest in this review of their own department's contingent liabilities, and arrange for the results to be reported to the Treasury before the Summer Recess. To ensure that similar reviews are carried out at no less than yearly intervals, I am asking the Treasury to ensure that a reminder is incorporated in the regular expenditure Survey procedure, so that the outcome of each department's review can be noted in the annual Survey report.

Margaret Thatcher

23 May 1986

PRIME MINISTER

The Treasury have now themselves suggested that you might minute colleagues about contingent liabilities.

You said earlier that you did not want to do so. However, it is an important subject, and a good minute, and I hope you will consider signing it.

DAVID NORGROVE

16 May 1986

LOSAAR

002/2769

CCBG

Treasury Chambers, Parliament Street, SW1P 3AG

D R Norgrove Esq
Private Secretary
10 Downing Street
London
SW1

15 May 1986

Dear David

CONTINGENT LIABILITIES

Thank you for your letter of 28 April.

The Chief Secretary agrees that it would be useful to emphasise again to departments their direct responsibility for liabilities arising in their own areas. The existing instructions ensure that liabilities are reported to Parliament when they are undertaken. The point which might be further stressed is that, even when liabilities have been undertaken, departments should take all available steps within their power to minimise the risk of the liability maturing, or its amount if it does. It is important that this is given proper attention by Ministers and senior management in departments, and not simply regarded as a matter of routine reporting.

The Prime Minister is already separately pursuing the position in ECGD, which accounts for a very large element in the present contingent liabilities. On the others, the Chief Secretary feels it would be helpful if the Prime Minister were willing herself to ask Ministers in charge of departments to look personally at their department's current contingent liabilities, and report the outcome of this review to the Treasury. To avoid the matter being overlooked in future years, we could arrange for the assessment of contingent liabilities to be brought within the Survey procedure, and ask each department to record the outcome in a paragraph in the annual Survey report.

If the Prime Minister agrees with this method of handling the matter, I enclose a draft minute which she could use. The Treasury will monitor the departmental replies and the Chief Secretary will send a further note to the Prime Minister if, in the light of that, any further steps seem to be needed.

Yours,
Jill

JILL RUTTER
Private Secretary

LOJ AAS.

DRAFT MINUTE TO MINISTERS IN CHARGE OF DEPARTMENTS

CONTINGENT LIABILITIES

The recent collapse of the International Tin Agreement, leaving a massive deficit on its operations, has been a sharp reminder of the importance of guarding against commitments carrying a risk of imposing contingent liabilities on government in later years.

2. The guidance to departments on this subject has recently been tightened up by the Treasury and reissued in the new edition of "Government Accounting" and I trust that it will be closely observed. There are two points in particular which I should like to stress.

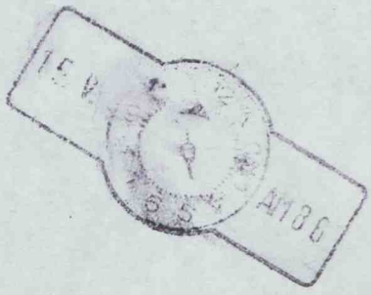
3. The first is that there needs to be a most careful and thorough appraisal of the risks, including the legal aspects, before any contingent liability is accepted. The only sure control over contingent liabilities is not to assume them in the first place. Particular vigilance should be exercised in the case of non-statutory assurances which may be construed as placing a financial obligation, moral or legal, on the government.

4. The second is the need to keep a careful watch on those contingent liabilities which have already been assumed. Any payment arising from a maturing liability

will place a burden on the expenditure programme of the department responsible for the activity in question. As well as complying with the formal reporting arrangements, Departments need regularly to look at all their outstanding contingent liabilities and consider whether all available steps are being taken to minimise the risk of a payment being required, or its amount. This review should cover contingent liabilities arising both from the department's activities and from those of public sector bodies which it sponsors. It must not be assumed that the Reserve is available to protect any department from the consequences of failing to exercise this vigilance.

5. I ask all Ministers in charge of departments to take a personal interest in this review of their own department's contingent liabilities, and arrange for the results to be reported to the Treasury before the Summer Recess. To ensure that similar reviews are carried out at no less than yearly intervals, I am asking the Treasury to ensure that a reminder is incorporated in the regular expenditure Survey procedure, so that the outcome of each department's review can be noted in the annual Survey report.

Trade, ECGD; 1/80



SCH

CBG

10 DOWNING STREET

From the Private Secretary

28 April 1986

Dear Jill,

CONTINGENT LIABILITIES

The Prime Minister was grateful for the Chief Secretary's minute of 4 April about contingent liabilities, and for the full report which was attached to it.

The Prime Minister appreciates that the Treasury have increased their efforts to ensure proper control and monitoring of contingent liabilities. However, the Prime Minister believes there is a case for departments to be made still more aware of their own primary responsibilities for contingent liabilities the Government takes on in their areas of responsibility. She has asked that consideration should be given to an annual assessment - more comprehensive than that at present reported to Parliament - to be carried out by each department on its own behalf, and, as necessary, the public sector organisations which it sponsors.

Yours,

David.

DAVID NORGROVE

Ms. Jill Rutter,
Chief Secretary's Office,
H M Treasury

6

PRIME MINISTER

CONTINGENT LIABILITIES

I would be somewhat less dismissive than the Policy Unit of the Treasury's efforts in controlling and monitoring contingent liabilities. The Government's contingent liabilities are amorphous, hard to define and hard to control. But the tin experience shows that greater efforts are needed.

It would be better for Departments themselves to be given the primary responsibility for monitoring their contingent liabilities, rather than setting up a new centrally managed bureaucratic exercise.

Agree that the Treasury should consider a more comprehensive annual assessment to be carried out by each Department on its own behalf and, as necessary, the public sector organisations which it sponsors. ~~and that you would be prepared to write to colleagues if need be to start this off?~~

Yes - but not for me to write

DN

DAVID NORGROVE
25 April 1986

CJ41

18 April 1986

PRIME MINISTER

CONTINGENT LIABILITIES

The Treasury's advice has recently been overhauled but it remains a complacent, unsatisfactory document. Control is patchy and bound to be less than adequate unless people know the amount of their contingent liabilities and commitments. The way to achieve this, as is normal in industry and commerce, is to establish a proper procedure for an annual review in each Department. This necessary discipline would be comparable with assessments of loan losses and commitments regularly made by commercial banks.

The accounting procedures should require an annual assessment in respect of each Department and public sector organisation as to the nature and amount of contingent liabilities and the amount of any such contingencies which may have crystallised during the year. Provision should be made in the public expenditure round for liabilities likely to be called. We believe that a system on these lines would both discourage the assumption of contingent liabilities and improve their control. It would also focus the minds of those concerned on the need to assess the possible financial consequences and risks of decisions to assume commitments.

Recommendations

Ask the Chief Secretary to:

1. establish an annual review of contingent liabilities by department;

2. introduce accounting control of contingencies augmenting the present system of reporting to Parliament.

David Hobson

DAVID HOBSON

008/1289

CONFIDENTIAL

DN o/r.

cc BS

FROM: CHIEF SECRETARY
DATE: 4 April 1986

BF for PU comments.

PRIME MINISTER

CONTINGENT LIABILITIES

... I enclose a report which my officials have prepared on this subject as requested in your Private Secretary's letter to mine of 10 March.

2 The subject of contingent liabilities has been taken very seriously by my department since the Crown Agents affair. As a result, advice went out to departments generally which was aimed at avoiding the kind of surprise with which that episode confronted the Treasury. Unfortunately, however, it failed to prepare us for the potential liability in respect of the recent failure of the International Tin Agreement, mainly because the guidance did not stress clearly enough the need for good detailed legal advice before we sign international economic agreements.

3 The Treasury's advice has recently been overhauled and a copy is attached at Annex A of my officials' report to me. I do not suggest that you need read it in detail but you will see that Annex C of the report promises a further submission on international economic commitments and commodity policy in particular.

Tin is discussed in annex C.

4 Departments are required to obtain Parliamentary authority for contingent liabilities, and to keep Parliament informed of outstanding liabilities outside those which arise incidentally to the normal course of their business.

5 Contingent liabilities which are undertaken as a deliberate act of policy are dealt with very much like actual expenditure. ECGD whose purpose is specifically to accept such risks in

CONFIDENTIAL

return for premiums is the most obvious example. The amount they can take on is controlled by statute and by an overall objective of no net cost to public funds taking one year with another. The commercial and political risks taken on are therefore carefully assessed country by country and since 1983, under guidelines approved by Ministers, there has been an increasingly rigorous approach. But ECGD do have a substantial overhang of liabilities taken on much earlier which cannot now be discarded and that is what is causing their present cash flow problems.

6 Where the undertaking of contingent liabilities is not controlled by statute there is a "by your leave" procedure agreed with the PAC, which gives both the Treasury and Parliament an opportunity to comment. The Department proposing to undertake the liability has to lay a Minute before Parliament and leave normally 14 days while Parliament is sitting before committing itself. A recent example is an MOD Minute covering the Defence Export Services Organisation's arrangements with Pakistan for the supply of warships.

7 There are also procedures for recording and reporting to Parliament the accumulated totals of such liabilities. These are separate from our systems for planning and controlling public expenditure which are based on cash. I agree with the assessment of my officials (paragraph 17 of the report at Annex A) that a notional insurance scheme within the public expenditure Survey is not a good idea. But if a liability matures into public expenditure I would expect the Minister concerned to find the money from within his PES plans, if necessary by making offsetting savings. Only if I was convinced that spending priorities could not be adjusted would I agree to charge expenditure to the Reserve within the planning total.

8 The possibility of a contingent liability occurs with almost everything the Government does or says. There is little real scope for controlling a contingent liability once it has

been incurred. The main burden of the Treasury's advice is therefore that Departments should avoid them wherever possible and minimise them when they are unavoidable. Letters of comfort are firmly discouraged.

JOHN MacGREGOR

CONTINGENT LIABILITIES

The Treasury guidance to departments on contingent liabilities is contained in "Government Accounting". It has recently been revised and the new version is attached as Annex A.

2. In essence departments are required to obtain some form of Parliamentary authority for contingent liabilities, and to keep Parliament informed of outstanding liabilities outside those which arise incidentally to the normal course of their business.

Statutory liabilities

3. ECGD liabilities are much the biggest item under this head. They are reported annually in the Department's Trading Accounts and also quarterly, in bulk, in British Business. Otherwise liabilities taken on under statutory powers are reported both at the time and annually thereafter (for the total amounts outstanding) in the Supplementary Statements to the Consolidated Fund and National Loans Fund Accounts (HC 117 for 1984-85)*. For completeness the ECGD figures are also included in the Supplementary Statements. ECGD's monitoring and control arrangements are described in Annex B.

Non-statutory Liabilities

4. Non-statutory liabilities generally require notification to Parliament under a Departmental Minute procedure which, wherever possible, allows time for Parliament to react before they are undertaken. The procedure also requires Treasury consent in each case. It has been agreed with the PAC. Amounts outstanding are reported each year with the main Estimates, and Parliament is assumed to take note of them when voting these Estimates.

5. There are a few exceptions to these arrangements as follows:

---

*For NI guarantees the liabilities are noted in the Supplementary Statements to the Public Income and Expenditure Account of Northern Ireland

(1) British Leyland

(2) Rolls-Royce Limited

(3) Short Brothers

(4) Harland and Wolff

In each of these cases the Government has made a public statement of support to enable the company to continue trading. The affairs of the companies are monitored by the responsible departments and, as public companies, they report publicly to their shareholders in the normal way.

6. International agreements too may impose contingent liabilities. The tin agreements are dealt with in Annex C. The Government has also accepted an unquantifiable liability to stand behind British Aerospace in relation to its commitments to Airbus Industrie which matches the commitments of the Governments of the other participants. Another example is the European Investment Bank where we are not only contingently liable for the uncalled capital but also guarantee certain loans outside the Community which are reported to Parliament annually in the introductory note to the Overseas Aid Vote.

7. Indemnities given (in lieu of insurance) by the museums and galleries in respect of items borrowed are reported annually to Parliament even though such borrowings may be seen as part of their "normal course of business" as in para 2 above.

"Letters of comfort"

8. Contingent liabilities deriving from "letters of comfort", where these have been issued, are treated in the same way as non statutory liabilities. The issue of letters of comfort is, however, strongly discouraged (paras 46-49 of the attached guidance).

NDPBs

9. Departments are enjoined to see that any NDPB's they sponsor follow similar disciplines and report any outstanding contingent liabilities in their accounts.

Other potential liabilities

10. There may even be latent contingent liabilities deriving from the mere fact that some institution has enjoyed Government support for a long time and so imposed an unspoken and unacknowledged liability for continuing support or winding up without loss to anyone. An important example is the universities, which are formally private sector institutions but which in practice are very largely dependent on public funds.

11. Even what might be called "letters or messages of discomfort" such as the warnings given about the pre-ratification period for the Channel Tunnel or about the Government's support for Birmingham's application to host the 1992 Olympic Games, may not in the end prove to have been effective in avoiding contingent liabilities. That is the thinking behind para 49 of the attached guidance. Ultimately, indeed, practically nothing can be said or done by Government without at least risking some sort of moral liability.

12. There is obviously some danger in admitting the possibility of a contingent liability outside the categories described in paras 2-7 above because the admission would be usable by a claimant in support of his claim. That is why the explicit recognition and reporting to Parliament of contingent liabilities is confined to cases where there is no doubt that a liability has been assumed.

Resources to meet maturing liabilities

13. In the case of ECGD payments are borne on Votes but the whole operation is a trading one intended to be in balance in the long run. The net result in any year is not classified as public expenditure (positive or negative). Otherwise, unless there is statutory authority to meet liabilities direct from the Consolidated Fund (e.g s.14(3) of the Civil Aviation Act

1982), the funds to meet maturing liabilities would have to be provided on votes. They are subject to PES limitations but, in practice, a large demand would be likely to involve a call on the Reserve provided within the planning total.

14. There has sometimes been a temptation, outside the Treasury, to regard guarantees as an easier option for supporting an increase in public sector activity, at the same time avoiding an increase in recorded public expenditure (at least until any guarantee is cashed). But such devices are not acceptable unless they are justified on their own merits, e.g in terms of the efficiency and management benefit that the private sector involvement can bring. In most such cases conventional public sector financing will be more cost effective for the taxpayer; and our procedures for handling proposals are framed accordingly.

Control and monitoring

15. The only effective control over contingent liabilities is not to assume them in the first place. Departments should take as much care in assessing the potential costs and benefits of such action as they do over any expenditure proposal. To the extent that Departments are vulnerable to claims on their PES provisions for maturing liabilities this will be a useful discipline, but only insofar as it is realistic to expect the PES programme to bear the full cost of an unforeseen claim.

16. Once the liability has been assumed, the arrangements for Parliamentary reporting and the noting of liabilities in the Estimates should ensure that the liability is kept under review, although this is of limited utility once the liability has been incurred. Knowledge of the liability does not always mean that there are practical steps which can be taken to remedy any emerging risk of a demand for payment. It is however incumbent on the Department to take whatever steps are available to it to avoid any emerging risk turning into an actual liability.

17. To guard against the risk that some liabilities will mature, one possibility would be to charge Departments a "premium" in the Public Expenditure Survey, against the risk that a claim would arise requiring some call on the Reserve. The calculation

of such a "premium" would however be intrinsically difficult, and it would have the disadvantage that the Department would then expect to disclaim responsibility for meeting claims from its own PES programme. It might therefore have less disincentive effect than at present to the assumption of bad risks. It would also seem inappropriate to ECGD, where the whole business is in any case the insurance of risks for a premium.

18. The most difficult area to guard against is where liabilities have not deliberately been undertaken by the Government, but it is simply assumed in the public mind that some liability, at least of a moral kind, may exist (see paragraphs 10-12 above). Such cases could not be covered by the system of notifications to Parliament without increasing the risk of claims being made. The only safeguard against these is vigilance to spot them emerging, and being prepared to issue a disclaimer in appropriate cases (eg as in the White Paper on the Channel Tunnel).

CONCLUSIONS

19. 1. Statutory liabilities are recorded and monitored in the same way as actual expenditure - particularly those of ECGD which reflect the whole purpose of the department.

2. The only effective control over specific and acknowledged non statutory liabilities is at the moment they are assumed. They are subjected to appropriate Parliamentary disciplines and reporting. Once they have been undertaken, assessment of the likelihood of expenditure must rely largely on departmental alertness and Treasury questioning.

3. Unacknowledged liabilities cannot be formally controlled and monitored but Departments and the Treasury must be vigilant to avoid such risks and consider the issue of disclaimers where practicable.

H M TREASURY **MARCH 1986**

ANNEX A

CONTINGENT LIABILITIES

26. This section is concerned with the contingent liabilities on the Consolidated Fund which arise when government departments and those non-Exchequer bodies (76) for which they are responsible accede to requests to give guarantees, indemnities or other assurances. Because of the risk that such assurances may have to be honoured and payments made, there should be a general predisposition against giving them.

27. However, where a body is effectively backed by government credit the long term interest of the taxpayer is likely to be best served by guaranteed borrowing (if not by direct government lending) since non-guaranteed borrowing is likely to be more expensive. Departments should ensure that the rate of interest on government-guaranteed borrowing is as low as possible and reflects the rate at which the government itself can borrow. Departments should not agree to borrowing on terms more costly than those available to the government without first consulting the Treasury.

28. This is particularly true when foreign borrowing is involved as any higher rate could reflect on the credit standing abroad by the United Kingdom public sector as a whole. All foreign borrowing by bodies for which deparetments have financial responsibilities must therefore be cleared with the Treasury in advance. (N 121).

29. In addition to the general policy considerations, departments should have close regard to the Parliamentary control aspects and to their responsibilities in relation to sponsored bodies, as indicated below.

Framework of Parliamentary control

30. Parliament authorises the issue of cash from the Consolidated Fund in two main forms. One is permanent legislation authorising issues directly. The other is through the annual Supply procedure leading eventually to the Appropriation Act, which completes the provision of specific amounts for specific purposes in specific financial years (B73).

31. A guarantee given by a Minister of the Crown is a legally enforceable undertaking that he will perform the promise or discharge the obligation of a non-Crown body in the event of that body's default. Although a Minister has freedom to give such guarantees, provided no statute expressly or implicitly precludes his doing so, he will only be able to pay for what he does if Parliament authorises the issue of the necessary funds (K5). Parliament is not bound in advance to authorise funds needed to honour a contingent liability assumed by a Minister of the Crown or his department unless the

liability has been charged by statute directly on the Consolidated Fund. This limitation, where it applies, must be made clear to the recipient at the time the guarantee is given. He may be told, in appropriate cases, of the existence of the Contingencies Fund (B101), from which it may be possible for the Treasury to make immediate payment in advance of vote authority.

32. Agreements between the government and the Committee of Public Accounts (PAC) have established conventions which ensure, so far as possible, that Parliament is not asked to authorise the provision of funds to meet liabilities of which it has not had reasonable notice and for which no justification had previously been provided. In order to respect these conventions, departments should be guided by the following considerations:

(a) **Inter-departmental liabilities** Because the Crown is indivisible, government departments cannot guarantee or indemnify one another, nor is it appropriate for them to issue letters of comfort or similar assurances to one another. Apart from any legal or consitutional implications, such a practice could be taken as anticipating the authority of Parliament to charge future expenditure to a particular vote, or to prejudice the government's decision on the question of replacement of a lost or damaged asset. Assurances required by the Export Credits Guarantee Department (ECGD) under recourse agreements are an exception to this rule necessitated by the statutory constraints within which that department is required to conduct its business. The resulting contingent liabilities are recorded in ECGD's annual trading accounts. In addition, departments which have given explicit assurances of this nature should take appropriate action to implement the guidance contained in sub-paragraph (c) below and succeeding paragraphs.

(b) **Normal course of business** A department's acceptance of a contingent liability in the normal course of business is not subject to any special procedures for notifying Parliament. Liaibilities in this category will normally be between the Government and one other party and be connected with the supply of goods and services for which Parliament already votes money, eg procurement, construction, trading activities, etc. For example, a department might accept an advance payment on a contract on condition that it will be refunded if the department is unable to provide the service paid for. Any payments in satisfaction of the liabilities would normally be chargeable to a subhead relevant to the service in question. In any case of doubt, the Treasury should be consulted. See also paragraph 45 on indemnities.

(c) **Other contingent liabilities**

(i) if a need to incur contingent liabilities arises from a continuing policy requirement, eg the giving of guarantees in support of borrowing by nationalised industries or companies in the private sector, the sponsor department should ensure that it has adequate statutory powers to provide guarantees with the consent of the Treasury.

(ii) Parliament should be given the earliest and clearest possible notice of a decision by a department to put public funds at risk by the assumption of a contingent liability.

(iii) Departments should make adequate arrangements for control and monitoring of contingent liabilities. They should report regularly to Parliament on the resulting exposure of public funds.

(iv) Most contingent liabilities in the industrial field are self-liquidating. Where this is not the case, the effective duration and extent of the guarantee or other form of commitment should be minimised and clearly stated as part of the express terms of the guarantee. This helps to restrict the total liabilities outstanding and ensures that fully considered solutions to industrial problems are not delayed because the immediate financial crisis is overcome.

(v) Departments should always consider whether some form of commitment fee, payable by the beneficiary of the guarantee or indemnity, would be appropriate, or a charge be established in the form of a deferred payment that could be reduced if the beneficiary was able to dispense with the guarantee, or any part of it, at an earlier date than agreed.

Reporting to Parliament

33. The following paragraphs describe the various types of contingent liability to be reported to Parliament[1] and explain how they bear on departments' responsibilities noted in paragraph 32(c)(ii) and (iii).

---

(1) Unless the relevant statute requires otherwise, departments should interpret the guidance on reporting to Parliament in the following manner. Departmental minutes on non-statutory guarantees should be laid before the House of Commons only; all other statements and reports provided for Parliament's information on contigent liabilities should be laid before both Houses of Parliament.

Statutory guarantees

34. Statutory guarantees are those where a Minister's powers to give guarantees are defined (and, by implication, limited) by statute. Some statutes provide for calls on a guarantee to be borne directly on the Consolidated Fund; others provides for any calls on the guarantee to be met from monies provided by Parliament, ie under the annual Supply procedure.

35. The statutory provisions governing the guarantees generally set out the responsible Minister's obligations to report to Parliamen (33N) on his exercise of a gaurantee power. The normal requirement is for a statement to be laid before both Houses of Parliament immediately a guarantee is given.(1) In addition, it may be necessary, particularly in the case of guarantees met directly from the Consolidated Fund, for statements to be laid in respect of any guarantees called, either at the time or subsequently. There may also be a requirement to report to Parliament annually or periodically on outstanding sums issued in respect of guarantees. Departments should ensure that the relevant reporting provisions in existing statutes are scrupulously observed. The proposed reporting arrangements should be set out explicitly in draft Parliamentary Bills (118). If no statutory procedure is laid down and the contingent liability could exceed £100,000, a statement should be laid before Parliament immediately a guarantee is given. The statement should indicate whether the liability is charged directly on the Consolidated Fund or whether the funds to meet it would require Parliament's approval through votes.

36. In all cases information about contingent liabilities resulting from statutory guarantees is published in the annual Supplementary Statements to the Consolidated Fund and National Loans Fund Accounts(2). Departments are required to submit a return to the Accountant, HM Treasury by the end of June each year, showing the nature of the liability, the relevant statute and the amount of the liability outstanding at the preceding 31 March.

---

(1) None of this applies to ECGD, which provides much the largest volume of statutory guarantees, to which separate Parliamentary reporting arrangements apply.

(2) Guarantees given under Northern Ireland legislation will be recorded in the section headed "Contingent Liabilities of the Consolidated Fund" in the Finance Accounts for Northern Ireland.

Non-statutory guarantees

37. Although specific statutory authority is desirable before any guarantee is issued, circumstances may arise, either at short notice or in circumstances unlikely to be repeated, where it is in the national interest for a guarantee to be given without statutory backing. In such cases the liability will be that of the sponsor department, and any payments required to meet a liability which is called will need to be charged to its vote. This should be acknowledged in the departmental Minute to be laid before Parliament (38).

38. Where the contingent liability could exceed £100,000, the following procedure, which has been agreed with the (PAC)[1], must be adopted. After obtaining Treasury approval, a department which proposes to give a guarantee must lay before Parliament a Minute describing the amount and duration of the guarantee and the body or bodies involved, and any other information relevant to the guarantee. Where the potential liability cannot be accurately quantified, an estimate should be given. In particularly large or complex cases it may be desirable for the Minister concerned to make a statement to Parliament supplementing the information contained in the Minute. The department should also send copies of the Minute to both the PAC and the relevant departmental Select Committee.

39. Approval of the guarantee should not be given until 14 days[2] after such a Minute has been laid before Parliament. Every effort should be made to ensure that the full waiting period falls while Parliament is in session. Where, in cases of special urgency, it is considered necessary to give a guarantee before 14 days have expired, the reasons for the urgency should be explained in the Minute.

40. If a Member of Parliament signifies an objection by letter, Parliamentary Question or Early Day Motion, the guarantee should normally not be proceeded with until the letter or Question has been answered or, in the case of an Early Day Motion, the Member or Members have been given an opportunity to make direct personal representations to the Minister. Where an objection, in whatever form, is signified, departments may wish to advise their Ministers to take the initiative by making contact with the Member or Members concerned. This may be particularly appropriate if it is proposed to issue the guarantee urgently or promptly on expiry of the waiting period. In all such cases the Treasury should be notified of the outcome of any representations made by Members.

---

(1) PAC Tenth Report, Session 1976-77, paragraphs 57-67

(2) Exclusive of Saturdays and Sundays.

41. The opening and closing paragraphs of the Minutes should follow a standard form as follows:

Opening paragraph -

"It is the normal practice, when a government department proposes to undertake a contingent liability in excess of £100,000 for which there is no specific statutory authority, for the department concerned to present to Parliament a Minute giving particulars of the liability created and explaining the circumstances; and to refrain from incurring the liability until 14 days (exclusive of Saturdays and Sundays) after the issue of the Minute, except in cases of special urgency."

Closing paragraph -

"The Treasury has approved the proposal in principle. If, during the period of 14 days (exclusive of Saturdays and Sundays) beginning on the date on which this Minute was laid before Parliament, a Member signifies an objection by giving notice of a Parliamentary Question or by otherwise raising the matter in Parliament, final approval to proceed with incurring the liability will be withheld pending an examination of the objection."

The wording of the closing paragraph will of course need to be adapted where, for reasons of urgency, it is proposed to issue the guarantee before the expiry of the normal 14 day period (39). It is also necessary to include in the Minute the following sentence:

"If the liability is called, provision for any payment will be sought through the normal Supply procedure."

42. Parliament should be kept informed of any change in the nature or increase in the size of the risk covered by the guarantee. Moreover, as long as a guarantee remains in force a note should be appended to the annual Supply Estimate of the relevant vote showing the size of the commitment outstanding at the latest convenient date.

Indemnities

43. An indemnity in its widest sense includes a guarantee, but is normally distinguished in law on the basis that a guarantee is ancillary to a contract between the recipient of the guarantee and the principal debtor, whereas in the case of an indemnity the promisor undertakes an original and independent obligation to make good some loss.

44. Examples of circumstances where a department may wish to consider the giving of an indemnity are as follows:

(a) Where a department receives on loan an object of value from a non-Exchequer source and the owner, as a condition of loan, insists upon

the continuance of current insurance, the receiving department should make every effort to persuade the lender to accept an indemnity in place of insurance (104).

(b) Indemnities are sometimes given in respect of services, as distinct from objects, provided to a government department. An example is the use by a department of premises and facilities belonging to an outside body. In such a case it may be necessary to give an indemnity to safeguard the body against damage to its buildings or equipment, or personal injuries to its staff, arising from the government use of the facilities. The department should, however, exclude from the scope of the indemnity any damage or injury attributable to negligence on the part of the indemnified body or of its contractors, agents or employees.

45. Indemnities may be of either a statutory or a non-statutory nature. The issue of most indemnities will be in the normal course of business (32(b)), but when they are not, the same Parliamentary procedures are applicable as to guarantees, unless the indemnity is authorised by a statute which specifies other procedures. Indemnities against loss or damage given to lenders or objects for exhibition by national museums and galleries are subject to separate reporting arrangements.

Letters of comfort

46. There is no simple or accepted definition of a letter of comfort. In the private sector the phrase typically refers to a letter issued by a parent company to a creditor of a subsidiary or associated company to give reassurace that the parent company is aware of financial obligations being assumed by the subsidiary or associate. In certain cases an indication may be given or implied as to the parent company's likely reaction should a subsidiary or associate subsequently fall into financial difficulties. But the essence of a letter of comfort is that it is intended to give some reassurance to the creditor without the parent company being legally bound, in all circumstances, to stand behind the subsidiary's obligations.

47. While a private sector body may be able to sustain a position in which it is bound morally but not legally, a public sector body, which is ultimately dependent on government credit, is unlikely to be able to issue a document of this kind without effectively committing government credit and having to meet the obligation if it should materialise. Moreover, although it has no automatic legal effect a letter of comfort could lead to a threat of legal action, which might have implications for government credit.

48. Departments should therefore approach any request for the issue of a letter of comfort with a strong pre-disposition to reject it. If, exceptionally, a Department believes there may be valid reasons for giving an assurance of this kind in a particular case the Treasury should be consulted in advance. If the Treasury agrees to the issue of a letter of comfort then the department should arrange for the matter to be laid before Parliament in a way analogous to that prescribed for guarantees in paragraphs 38-42. Legal advice should be sought on the terms and implications of any such letter and report to Parliament.

49. Departments should similarly beware of issuing letters which although not intended as comfort letters may, because of the fact that they are issued at all, be interpreted as implying a degree of comfort, for example, letters to financial institutions, banks, other lenders, or their agents which comment on, and thereby acknowledge, the financial arrangements proposed in particular cases. The presumption must in such cases be even stronger that such letters should not be issued. The Treasury should be consulted if, for any reason, this presumption is thought not to apply to a particular case.

General statements of support

50. Circumstances may arise in which a government department needs to make a general public statement of support for an outside body. For example, it may be desired to reassure creditors about the creditworthiness of a Companies Act company wholly or partly owned by the government, and that in the event of liquidation the government will ensure that the valid claims of the creditors are met. Such a statement involves the assumption by the government of a potential extra liability, albeit an unquantifiable one, and should be notified to Parliament at the earliest opportunity after clearance with the Treasury. The effect of such a statement is to bring the body concerned into the category discussed in paragraphs 50-54 below. Where such a statement is likely to be the prelude to successive borrowing operations by the body effectively on government credit, the department should ensure that it is equipped with appropriate statutory powers for the purpose in accordance with paragraph 32(c) above.

Non-Crown bodies dependent on government credit

51. Contingent liabilities of nationalised industries and other non-Crown bodies which are ultimately dependent on goverenment credit are not normally under the direct control of departments; but since they may in certain circumstances incur a contingent liability which will have to be met, if it natures, from public funds, departments should be especially alert to their responsibilities under paragraph 32(c) above. (See also N119-123).

52. In general, such bodies are creatures of statute, either specific or general under the Companies Acts, or are established by Royal Charter, and have no legal powers to enter into commitments outside their defined powers. In the normal course of business they may be required to enter into commitments eg in the case of trading bodies for the supply and the receipt of goods and services, and may need to give assurances of various kinds incidental to these transactions. But departments should satisfy themselves that there are adequate arrangements in force to ensure that the acceptance of contingent liabilities in any other situation is consistent with the body's defined powers and that, in the event of the liability maturing, the body would have the ability to meet it, if necessary by borrowing within any borrowing limits. In the case of international organisations to which the United Kingdom belongs, it is particularly important that the relevant international agreement clearly sets out the financial responsibility of the members for discharging all its obligations including guarantees and contingent liabilities.

53. In particular, departments should ensure that the bodies concerned have adequate internal procedures with regard to the issue of assurances in the form of comfort letters and consult the department and the Treasury before issuing such letters. In addition, they should ask the bodies to be guided by the government's view that any assurance in the form of comfort letters in relation to borrowing should be treated in their accounts on the basis of an analogy with legally enforceable contingent liabilities. If, in cases where the relevant borrowing is counted against statutory borrowing limits, the liability arising out of a letter of comfort is excluded from the note to the accounts relating to contingent liabilities on the ground that it is covered by a separate note comparing borrowings against limits, this should be explained in the note relating to contingent liabilities.

54. As legislative opportunities present themselves, departments should take steps to ensure that the statutory financial limits of statutory bodies for which they are responsible include borrowings by subsidiary companies (in the Companies Act sense) and borrowings by any other party which have been guaranteed by the parent body or in relation to which the parent body may have issued any comfort letters or similar assurances.

55. Where such arrangements are not already in operation departments should arrange to be consulted by the bodies they sponsor before new or renewed guarantees or letters of comfort in relation to borrowing above a specified limit are issued. Unless otherwise agreed with the Treasury, this limit should not exceed £1 million or any borrowing limit applicable to the body in question, whichever is less.

ANNEX B

ECGD : MONITORING AND CONTROL OF CONTINGENT LIABILITIES

ECGD's normal business as an insurer is to take on contingent liabilities for the repayment of trade credit and loans made in support of UK exports and in relation to UK owned overseas investment. The Department provides insurance within aggregate statutory limits on liabilities set under the Export Guarantees and Overseas Investment Act.

2. ECGD charges premia for the business it underwrites and the level and structure of these premia are intended to ensure that the Department operates at no net cost to public funds taking one year with another. This, and the fact that ECGD provides less than 100% cover, acts as a general check on the extent to which contingent liabilities are taken on.

3. In controlling liabilities on individual cases the risks arising from both commercial factors and economic/political factors are considered. The management of commercial risk is undertaken by assessment of the financial strength of the buyer, limiting exposure to an appropriate figure in each case, and where necessary seeking additional security. The economic and political risk is assessed by country and the terms of cover in each market determined in the light of that assessment: for the majority of markets cover is only available within a ceiling. Since 1983, under guidelines approved by Ministers, ECGD has taken a more regorous approach to the setting and observation of these limits with the aim of directing support to those countries best able to repay.

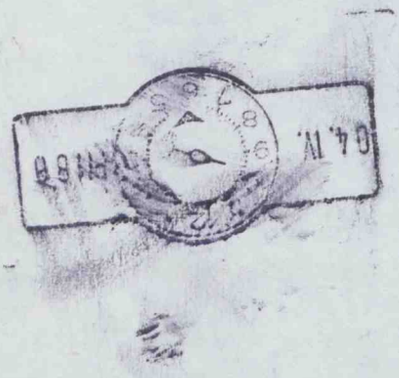
4. Once a guarantee has been given, ECGD are committed and often can do little to affect the outturn. However, where difficulties arise cases are monitored, and where possible action taken to avoid or minimise loss. Furthermore, as part of the implementation of the Management Review, the Department is exploring more sophisticated systems for managing and controlling contingent liabilities.

ANNEX C

TIN

Although the assessment and reporting of contingent liabilities was significantly tightened up as a result of the Crown Agents episode in the early 1970s, the administrative changes made to the control and monitoring arrangements did not explicitly cover international economic agreements. This is remedied in the new issue of Government Accounting. Individual new commitments were of course examined ad hoc as they were undertaken. (But, as the recent tin case has shown, the extent of contingent liabilities depends critically on legal interpretation of international agreements.) There was no systematic analysis of different types of liability, or the steps needed to minimise exchequer exposure under such Agreements. As a consequence of the tin experience, guidance and a checklist of actions applying to all similar international economic commitments has already been prepared, to ensure that financial risks are identified for Ministers before decisions are taken on new or extended agreements. It will be put to Ministers shortly, together with the results of an interdepartmental review of commodity policy being undertaken by DTI.

TRADE : ECED : Jan 1980



file

CCBG



10 DOWNING STREET

From the Private Secretary

27 March 1986

E.C.G.D.

The Prime Minister was grateful for the account of ECGD's position set out in your letter of 21 March.

DRN agrees – no longer need to chase
MA 17/4/86

The Prime Minister would be glad to be kept closely in touch with the performance of ECGD.

I am copying this letter to Paul Pegler (Chief Secretary's Office).

DAVID NORGROVE

Michael Gilbertson, Esq.,
Department of Trade and Industry

MR NORGROVE

24 March 1986

ECGD

The letter from DTI of 21 March is unsatisfactory. It suggests that a "cash deficit is not a loss and will not be so unless and until the international debtors renege on their obligations ...". Unfortunately the cash deficit has to be charged against the PSBR but apparently we need not recognise a loss provided countries such as Poland, Brazil or Nigeria go on making the right noises for another century or so. If they do not meet their interest charges or 'roll them up', this is just a further cash deficit to be charged against PSBR, not a loss.

This may be 'water under the bridge' but it is perhaps illustrative of the attitude which enabled such huge commitments to be built up. It makes the case for strengthening the management of ECGD even more pressing, so that risk may be better measured and danger signals recognised more promptly.

If the Bank of England were the supervisory authority for ECGD, they would not be content with the above accounting policies. Should the Treasury or the Bank be asked to look at them with a critical eye?

David Hobson

DAVID HOBSON

CONFIDENTIAL

DEPARTMENT OF TRADE AND INDUSTRY
1-19 VICTORIA STREET
LONDON SW1H 0ET
Telephone (Direct dialling) 01-215 5422
GTN 215) .....
(Switchboard) 01-215 7877

JU802
Secretary of State for Trade and Industry

21 March 1986

CONFIDENTIAL

David Norgrove Esq
Private Secretary to the
Prime Minister
10 Downing Street
London SW1

Prime Minister ?
Agree to ask to be kept closely in touch with the performance of ECGD?
DKV
26/3.

Dear David,

Thank you for your letter of 10 March about ECGD's cash deficits and the Management Review.

The cash deficits result almost entirely from the substantial level of claims being paid by ECGD to exporters whose payments from countries which have had to seek more time to pay their trade debts are in arrears. The arrears relate to business undertaken some years ago. The sums involved are substantial, and forecasting ECGD's cash flow is just as hazardous as forecasting the future course of the international debt problem as a whole. When Ministers collectively looked at ECGD's finances last July, three possibilities were considered - a "base case" envisaging a cumulative deficit rising to about £2bn, a 'pessimistic case' involving a deficit rising to £4bn, and a "crisis case" carrying the deficit to £6bn or more. In the course of the past year ECGD's cash requirement has been entirely consistent with last year's "base case" assumptions. However, in his recent appearance before the Commmittee of Public Accounts, Mr Gill indicated in effect that the future might prove closer to last year's pessimistic case. This is because of the higher amount of debt relief which we now envisage will be required by a number of major debtors, some of whom have been hard hit by the recent fall in oil prices. The main countries concerned are Nigeria, Mexico, Brazil and, in the fairly near future, Egypt. Despite the higher level of debt relief which will be needed, ECGD's cash deficit could probably still be contained within a figure of £2bn, if relief were provided through refinancing loans which would enable debts to be paid on time with ECGD carrying the risk of default on the new loan. We have resorted to

1786 1986 BOARD OF TRADE BICENTENARY

refinancing in a few cases so far where we were satisfied that the new loans would be paid on time. However, the four large debtors I have mentioned are to some extent at odds with the IMF. Unless these differences with the Fund can be reconciled, it may not be appropriate to refinance, in which case ECGD would pay claims to exporters and banks and wait for the money to be paid by the debtors in due course. Whether the Department's borrowing requirement will ultimately be closer to £2bn or £3bn is thus subject to a very wide range of uncertainty but, on prudential financial grounds, it would be wise to assume a figure close to £3bn by the end of the decade.

I must stress that this cash deficit is not a "loss" and will not be so unless and until the international debtors renege on their obligations. No one has yet reneged on these debts and there are strong pressures within the international financial system to ensure that debtor countries have every incentive to meet their proper obligations. The question is how long they will need in order to clear their debts and the rate of interest we receive on the debts while we wait. In their trading accounts, ECGD are setting aside increasing provisions against the possibility of an ultimate default, and the underlying trading accounts themselves have recently turned round from deficit to surplus. In other words, we have good reason to suppose that current business being underwritten on current terms and premium rates will pay its way, largely as a result of the defensive action the Department has taken in recent years for example through increased premium rates, tighter underwriting, a more rigorous approach to risk assessment, and a searching examination of loss making facilities. Indeed, many exporters are now concerned that the emphasis on ECGD's break even financial objective may be operating to the detriment of the statutory purpose to encourage trade. One symptom of this is the increasing number of controversial cases on which decisions about ECGD cover need to be taken at Ministerial level.

The Management Review is not directly related to the financial situation, though the emphasis in the review of business planning will have a very important part to play in judging the right balance between the financial duty and the statutory purpose of the Department. The review will also have a more important and significant effect on the Department's general operational efficiency underpinned by an appropriate use of information technology. The Department is now actively engaged in a wide ranging programme for implementing the review. Changes at Under Secretary level, including the recruitment on contract, after open competition, of an individual from the private sector to head up the Management Services Group, mean that the right people are now in the right places at Under Secretary level to give the

1786 1986 BOARD OF TRADE BICENTENARY

appropriate impetus to the implementation of the review. Useful progress has already been made both on the business planning side and at the operational levels. The Secretary of State and the Minister for Trade will be monitoring progress to ensure that the necessary momentum is maintained.

In summary:

i ECGD's cash position will be dominated for some years ahead by the continuing repercussions on past business of the world debt problem. The amounts are substantial and forecasting is subject to very wide margins of uncertainty.

ii Tighter underwriting and risk management has turned round the underlying trading position.

iii ECGD's present management team has made a good start in implementing the management review. Progress will be carefully monitored.

I am copying this letter to Paul Pegler (Chief Secretary's office).

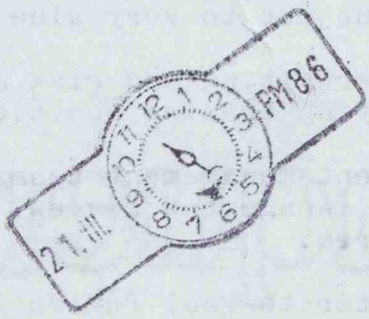
Yours ever,

Michael

MICHAEL GILBERTSON
Private Secretary

1786 1986 BOARD OF TRADE BICENTENARY

Trade ECGD; 1/80



STAFF IN CONFIDENCE

JU836
Secretary of State for Trade and Industry

DEPARTMENT OF TRADE AND INDUSTRY
1-19 VICTORIA STREET
LONDON SW1H 0ET
Telephone (Direct dialling) 01-215 5422
GTN 215) .....
(Switchboard) 01-215 7877

21 March 1986

David Norgrove Esq
Private Secretary to the
Prime Minister
10 Downing Street
London SW1

Dear David,

As a tail-piece to my letter of today's date about ECGD finances and the Management Review, I ought to add that, having recruited an Under Secretary equivalent from the private sector, we are now close to the point where the present head of ECGD can bow out with the minimum of disruption, and it is our present intention to open up the post to competition from the private sector within the next two or three months.

I am copying this letter to Paul Pegler (Chief Secretary's Office).

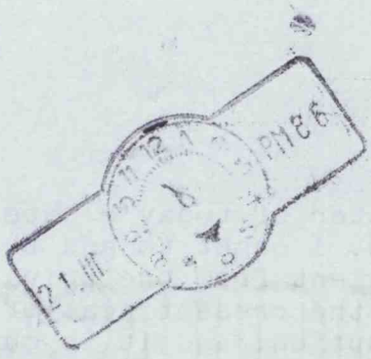
Yours ever,

Michael

MICHAEL GILBERTSON
Private Secretary

1786 1986 BOARD OF TRADE BICENTENARY

Trade ECGD 80



CONFIDENTIAL

Prime Minister!
Agree that you would like to be kept closely in touch with true financial position of ECGD? DRY 26/3.

MR NORGROVE

21 March 1986

ECGD EXPOSURE

The Bank report on the International Financial Scene dated 14 March has a table attached headed "Indebtedness and British Exposure" which shows ECGD exposure in certain listed countries at a total of $18.5bn (say, £12.5bn) at 31 December 1985, defined as "guaranteed principal and contractual interest plus political claims paid and claims under examination".

The largest exposures enumerated therein are:

	$bn
Brazil	1.8
Mexico	1.3
Indonesia	1.6
Poland	1.3
Romania	0.8
Yugoslavia	1.0
Egypt	0.9
Nigeria	3.2
South Africa	2.7
	$14.6bn (say £10bn)

Even if one accepts South Africa as a good risk, the possibility of the cost to the PSBR exceeding the expected £3bn by the end of the decade cannot be dismissed,

CONFIDENTIAL

particularly if Egypt and any other "oil economies" prove unable to meet their liabilities as and when they fall due.

There are no grounds for complacency, and the situation will need watching with care.

David Hobson

DAVID HOBSON

COPIED TO TRADE: TIN PT 2

FILE (54) ECL

bc BG

10 DOWNING STREET

From the Private Secretary

10 March 1986

CONTINGENT LIABILITIES

You will have seen my separate letter of today to John Mogg about ECGD's finances.

Concern about ECGD finances has prompted the Prime Minister to enquire what steps are taken to control and monitor the contingent liabilities entered into by Government. I should be grateful to have a report on this.

The Prime Minister would also be grateful to know whether the monitoring arrangements identified the International Tin Agreement as a potential liability for Government.

(David Norgrove)

Richard Broadbent, Esq.,
H.M. Treasury.

6

a BG

10 DOWNING STREET

From the Private Secretary

10 March 1986

ECGD

The Prime Minister's attention has been drawn to recent ECGD evidence to the Public Accounts Committee which foreshadowed losses by the end of the decade of up to £3 billion compared with a figure of £2 billion expected a year ago.

In the light of this, the Prime Minister would be grateful for a progress report on the implementation of the ECGD Management Review of May 1985.

I am copying this letter to Richard Broadbent (Chief Secretary's Office).

David Norgrove

John Mogg Esq
Department of Trade and Industry

JB

Prime Minister 4

Agree to write as proposed? (ECGD are almost certainly to blame for some of the losses – but successive Governments have been extremely reluctant to make drastic reductions in credit limits.)

DLJ 6/3.

PRIME MINISTER 5 March 1986

ECGD

Yes (i) r (ii)

The recent tin crisis has highlighted the danger of contingent liabilities entered into by government crystallising as actual losses.

Recent ECGD evidence to the Public Accounts Committee foreshadowed a total cash shortfall by the end of the decade of up to £3 billion compared with £2 billion expected a year ago. Annual costs to the PSBR are of the order of £300-£400 million.

The losses arise from commitments entered into some years ago to insure exports to Poland, Brazil, Nigeria, Mexico and elsewhere. The financial position of most countries concerned makes refinancing of these commitments unlikely. ECGD got deeply involved in these countries some years ago, as did many banks, but may have read the danger signs more slowly.

These disastrous results pinpoint the continuing need to improve management at ECGD. One Under Secretary has been recruited from outside the Civil Service to deal with information technology. It is expected that by the summer efforts will be made to recruit a new Secretary of the Department from commercial sources.

You may wish to:

i. Request a progress report from DTI on the implementation of the ECGD Management Review of May 1985.

ii. Enquire from the Chief Secretary what steps are taken to control the level of contingent liabilities entered into by Government. ECGD, tin and Varley-Marshall assurances are examples.

Agree both

David Hobson

DAVID HOBSON

Prime Minister

I believe ii above to be well worth doing. Some years back Sir Douglas Allen carried out a similar exercise after the Crown Agents debacle. I don't know whether he identified the Tin Agreement as a potential liability.

N C J

6.3

MANAGEMENT AND APPOINTMENTS IN CONFIDENCE

DEPARTMENT OF TRADE AND INDUSTRY
1-19 VICTORIA STREET
LONDON SW1H 0ET
TELEPHONE DIRECT LINE 01-215 5422
SWITCHBOARD 01-215 7877

Secretary of State for Trade and Industry

4 November 1985

MANAGEMENT AND APPOINTMENTS IN CONFIDENCE

D Norgrove Esq
Principal Private Secretary to the
Prime Minister
10 Downing Street
LONDON
SW1

Dear David,

EXPORT CREDITS GUARANTEE DEPARTMENT - TOP MANAGEMENT

At a meeting of E(A) chaired by the Prime Minister in July a number of decisions were taken about the organisation of ECGD, in the light of the recommendations of a recent Management Review.

2 It was agreed, inter alia, that three of the Department's Under Secretary posts (increased from four to five) should be filled over a period of time by secondments from the private sector. This was instead of the recommendation in the Management Review that there should be a board of external part-time executive directors. However it was noted that if the right people could not be found, or if they failed to achieve the desired results, further consideration might have to be given to the appointment of a board.

3 Applicants for an immediate Under Secretary vacancy are now being scrutinised following a public advertisement, and in line with the E(A) decision, space would need to be created in the coming months to accommodate two other secondees. However there is now a new factor which gives Ministers a further option. The present Head of ECGD, Mr Jack Gill, a Deputy Secretary, has applied for early retirement. As he is in his 40th year of public service there is unlikely to be any difficulty about the application, and my Secretary of State and the Minister for Trade would like to fill the post from outside (probably next March).

DW1ABL

999-1

4 They believe that we are much more likely to find a good outside candidate for the top job than for non-specialist Under Secretary posts. It would give the strongest possible signal of the Government's intention to make ECGD more businesslike. My Ministers believe it would be well within the spirit of E(A) decision to fill the top post and one of the Under Secretary posts from outside. The remaining four Under Secretary posts would remain within the Civil Service, but we would want to see more interchange at that level between ECGD and the DTI than there has been in the past.

5 The post could be filled either by a secondment or by a short period appointment, depending on the availability and circumstances of the best qualified candidate. Unless the Prime Minister sees any objection, my Ministers would like the MPO, in consultation with this Department and the Treasury, to set in train immediately the procedures necessary to fill the job. My Ministers are naturally anxious to ensure that all the relevant procedures are scrupulously followed.

6 I am sending copies of this letter to Michael Stark (Cabinet Office), Paul Thomas (MPO), Rachel Lomax (HMT), and to Dennis Trevelyan.

J F MOGG
Private Secretary

DW1ABL

7/267/5724

CC NO

DEPARTMENT OF TRADE AND INDUSTRY
1-19 VICTORIA STREET
LONDON SW1H 0ET
Telephone (Direct dialling) 01-215)
GTN 215) 5144
(Switchboard) 215 7877

From the Minister for Trade

NBPM

AT 31/7

The Rt Hon Nicholas Edwards MP
Welsh Office
Gwydyr House
Whitehall
LONDON
SW1A 2ER

30 July 1985

Dear Nick,

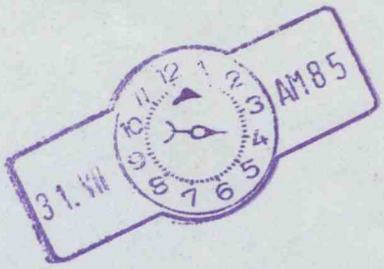
Thank you for your letter of 24 July and for your letters of 10 and 17 July to Norman Tebbit about the ECGD Management Review.

We have already discussed some of the points raised in your letters.

I take your point that we need to handle the press carefully and I have already met lobby correspondents from the Western Mail and BBC Wales. It was helpful to know in advance the line you proposed to adopt in reply to questions on our decision on the Review. I have no difficulty with these although I should point out that the reference in sub-paragraph (c) of your letter should be to "all short term guarantee business" and not to "small to medium guarantee business". ECGD's business is broadly categorised by the length of credit granted by exporters and it is essentially the short term (up to six months credit) business that is handled in Cardiff. But there are, of course, some very large exporters within the field.

We are agreed that we should press ahead with the Review's recommendations designed to provide a more professional and cost-effective service to exporters. Some recommendations involve the relocation of functions between Cardiff, London and the Regional Offices. You have asked that consideration be given to the possibility of locating the Management Services Group in Cardiff. In fact, computer staff account for the majority of those employed in this Group and they are, of course, already based in Cardiff (mainly Llanishen) and their number is likely to be increased. There may be some scope for locating the management function of this Group in Cardiff and your suggestion will be examined further as detailed plans are drawn up for implementation. However, this option will need to be weighed against the





needs of the organisation as a whole and should not be allowed to prejudice our ability. We shall also have to find a suitable way of finding from the Private Sector the best person available to head up the Group.

I am sending a copy of this letter to Members of E(A) and to Sir Robert Armstrong.

PAUL CHANNON

NDM
BT 2417

~~CENC~~

SWYDDFA GYMREIG
GWYDYR HOUSE
WHITEHALL LONDON SW1A 2ER
Tel. 01-233 3000 (Switsfwrdd)
01-233 6106 (Llinell Union)

Oddi wrth Ysgrifennydd Gwladol Cymru

WELSH OFFICE
GWYDYR HOUSE
WHITEHALL LONDON SW1A 2ER
Tel. 01-233 3000 (Switchboard)
01-233 6106 (Direct Line)

From The Secretary of State for Wales

The Rt Hon Nicholas Edwards MP

24th July 1985

Dear Paul

ECGD MANAGEMENT REVIEW

I have seen the draft Parliamentary Question and Answer which it is proposed to table today.

While I do not object to the terms of the Answer, I must advise that there will immediately be questions in South Wales about the effect on employment in Cardiff. The background material that your officials were good enough to send to mine explains that no estimate can be given but it makes quite clear that the recommendations involve "streamlining procedures for underwriting and paying claims on short-term business" - which those in the know will conclude to refer particularly to Cardiff.

In my view trouble will be saved if the Western Mail and representatives of other media in Wales are included in any briefing by your office. In view of the interest shown by South Wales' MPs (particularly Jim Callaghan) it will be necessary for my Department to deal robustly with questions. In view of our discussion before E(A) the intention here is to reply to questions on the following lines:

(a) the decision does not represent a reversal of Government policy for decentralisation;

(b) nor does the possibility of changes in the operation of the ECGD in Cardiff reflect in any way on the suitability of the City of Cardiff as an excellent and convenient location for financial service operations;

(c) the Cardiff operation of ECGD will continue and, as the nerve centre (in your words) of the small to medium guarantee business, will have a long future before it;

/(d) while it ...

The Rt Hon Paul Channon MP
Minister for Trade
Department of Trade and Industry
1 Victoria Street
London
SW1H QET

(d) while it is not at present possible to establish how many posts will be reduced in Cardiff, we may expect the number to be of some significance, since the aim (which I support) is to increase the use of modern statistical methods and technology and so provide a more cost-effective and efficient service to the customer; we expect changes to be phased so as to keep redundancies to a minimum.

I am still far from convinced that economical and effective operation is more difficult in Cardiff than in London and, indeed, I shall be raising this point in connection with the difficulties of another governmental body, wholly based in the Home Counties, which is experiencing acute difficulties of recruitment. With this in mind I feel that I must press you strongly once again to give a favourable answer to my suggestion that serious consideration be given to locating the management services and finance group in Cardiff.

I am sending a copy of this letter to Members of E(A) and to Sir Robert Armstrong.

Y SWYDDFA GYMREIG
GWYDYR HOUSE
WHITEHALL LONDON SW1A 2ER
Tel. 01-233 3000 (Switsfwrdd)
01-233 6106 (Llinell Union)

Oddi wrth Ysgrifennydd Gwladol Cymru

WELSH OFFICE
GWYDYR HOUSE
WHITEHALL LONDON SW1A 2ER
Tel. 01-233 3000 (Switchboard)
01-233 6106 (Direct Line)

From The Secretary of State for Wales

The Rt Hon Nicholas Edwards MP

24th July 1985

Dear Paul

ECGD MANAGEMENT REVIEW

I have seen the draft Parliamentary Question and Answer which it is proposed to table today.

While I do not object to the terms of the Answer, I must advise that there will immediately be questions in South Wales about the effect on employment in Cardiff. The background material that your officials were good enough to send to mine explains that no estimate can be given but it makes quite clear that the recommendations involve "streamlining procedures for underwriting and paying claims on short-term business" - which those in the know will conclude to refer particularly to Cardiff.

In my view trouble will be saved if the Western Mail and representatives of other media in Wales are included in any briefing by your office. In view of the interest shown by South Wales' MPs (particularly Jim Callaghan) it will be necessary for my Department to deal robustly with questions. In view of our discussion before E(A) the intention here is to reply to questions on the following lines:

(a) the decision does not represent a reversal of Government policy for decentralisation;

(b) nor does the possibility of changes in the operation of the ECGD in Cardiff reflect in any way on the suitability of the City of Cardiff as an excellent and convenient location for financial service operations;

(c) the Cardiff operation of ECGD will continue and, as the nerve centre (in your words) of the small to medium guarantee business, will have a long future before it;

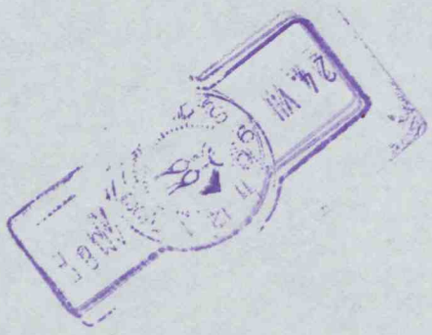
/(d) while it ...

The Rt Hon Paul Channon MP
Minister for Trade
Department of Trade and Industry
1 Victoria Street
London
SW1H QET

(d) while it is not at present possible to establish how many posts will be reduced in Cardiff, we may expect the number to be of some significance, since the aim (which I support) is to increase the use of modern statistical methods and technology and so provide a more cost-effective and efficient service to the customer; we expect changes to be phased so as to keep redundancies to a minimum.

I am still far from convinced that economical and effective operation is more difficult in Cardiff than in London and, indeed, I shall be raising this point in connection with the difficulties of another governmental body, wholly based in the Home Counties, which is experiencing acute difficulties of recruitment. With this in mind I feel that I must press you strongly once again to give a favourable answer to my suggestion that serious consideration be given to locating the management services and finance group in Cardiff.

I am sending a copy of this letter to Members of E(A) and to Sir Robert Armstrong.



P 01594

PRIME MINISTER

Meeting of E(A) on 17 July 1985

Export Credits Guarantee Department (ECGD)

(E(A)(85) 46 and 47)

BACKGROUND

1. The purpose of this meeting is to consider two related issues:

(i) the outcome of a recent Management Review of ECGD which was set up last year following the unsatisfactory report by Sir Peter Matthews, and is discussed in the paper E(A)(85) 46 by the Secretary of State for Trade and Industry;

Flag A —

(ii) a memorandum by the Chief Secretary (E(A)(85) 47) on the ECGD 1985 Business Plan and measures to strengthen ECGD's financial prospects in the period to 1989-90.

Flag B —

Business Plan and Financial Prospects

2. ECGD has a current exposure of £32 billion and takes on liabilities of around £16 billion per annum. In each of the last five years, it has had a negative cash flow and its cumulative cash deficit with the Consolidated Fund - the measure of ECGD's call on the Public Sector Borrowing Requirement (PSBR) - stood at £342.5 million on 31 March 1985. Between March 1983 and March 1985, ECGD's trading reserves - the measure of its underlying financial strength - fell from £862.5 million to £575.5 million and further reduction seems certain. On a Base Scenario, ECGD's cumulative deficit with the Consolidated Fund is expected to increase to £2 billion by 1990. Other scenarios - Pessimistic and Crisis - show cash deficits of over £4 billion and over £6 billion, demonstrating the sensitivity of ECGD's financial position to the external psoition of the major borrowers. New business is expected to be underwritten profitably, but the impact of cash flow deficits and losses arising from

the old business will persist for some years. This suggests there is little prospect that ECGD will meet the financial targets for size and quality of reserves set by Ministers last year (set out in paragraph 5 of the Annex to E(A)(85) 47).

3. The Minister for Trade and the Chief Secretary have already agreed some specific measures to improve ECGD's financial performance and limit the burden on the PSBR. These are:

(a) premium increases of around 10 per cent from 1 July, particularly for high risk business, with premium levels kept under review;

(b) measures to improve the performance of the comprehensive short-term insurance business (75 per cent of the total) through improved underwriting performance, reduced administrative costs, a new marketing strategy and a better balance of risk exposure of the short-term portfolio;

(c) a continuing review of uneconomic facilities;

(d) refinancing rather than rescheduling claims payments wherever possible (this avoids an immediate addition to the PSBR, although the monetary effects are similar).

4. The Chief Secretary now proposes, on the basis of ECGD's 1985 Business Plan, that:

(a) the Sub-Committee note ECGD's financial position and its consquences for the PSBR, the action already taken to secure the profitability of new business, and the need to keep less profitable business under closer review;

(b) the private sector should be encouraged to increase its involvement in credit insurance business - in the longer term it may prove possible to privatise the separate short-term business which the Management Review recommends should be created;

(c) ECGD's objectives of encouraging exports must continue to be subject to the break-even financial constraint;

(d) ECGD should be instructed to prepare a Corporate Plan for 1986 to give Ministers a range of quantified options for the amount and distribution of risk to be accepted in future;

(e) ECGD's interim objectives should be to underwrite new business profitably, within existing market limits, subject to any agreed changes;

(f) no special arrangements should be made for arms sales, but the 1986 Corporate Plan should take their needs into account.

Management Review

5. On the Management Review, Mr Tebbit concludes that in present conditions privatisation is not an option. He accordingly proposes:

(a) that ECGD's role should be to provide the best service to exporters within the financial constraints agreed by Ministers, while allowing the private market to grow at its own pace;

(b) to reject the Management Review's recommendation for a part-time executive Board: instead, he proposes to fill two of ECGD's Under-Secretary posts from the private sector and to implement the organisational changes over a 3-4 year period;

(c) that flexible pay arrangements be adopted for ECGD, if necessary as a controlled experiment;

(d) ECGD should develop a system of portfolio management for handling political risk (in essence this entails looking at the implications of particular cases for the portfolio as a whole rather than in relation to individual countries).

MAIN ISSUES

6. The main issues are likely to be:

(a) The role of ECGD and possible private sector involvement;

(b) ECGD's future Financial Strategy;

(c) The Government's response to the recommendations in the Management Review.

The Role of ECGD and possible private sector involvement

7. Since he judges that privatisation is not at present an option (the private export insurance sector is still small and would be unable to fill the gap if ECGD withdrew), Mr Tebbit proposes that, within the financial constraints agreed by Ministers, ECGD's role should be to provide the best service to exporters while allowing the private market to grow at its own pace. ECGD must therefore be allowed to market its facilities so as to achieve a balanced portfolio of risks under its break-even remit. The Chief Secretary agrees with this. At the same time both the Chief Secretary and Mr Tebbit wish to encourage the growth of the private sector. The Chief Secretary believes that in the longer term it may be possible to privatise the separate short-term business of ECGD which the Management Review proposes should be established in Cardiff.

8. The role of ECGD as a guarantor of export finance is unlikely to be affected by the work of a group on export financing led by the Bank of England. That is expected to conclude that there is now less enthusiasm in the City for a new institution in export financing, although an increasing proportion of exports may be financed from capital markets by bond issues.

ECGD's Future Financial Strategy

9. The Chief Secretary and the Minister for Trade have already agreed some measures to improve ECGD's financial performance. These are summarised in paragraph 3 above. The general aim of the strategy is to minimise the impact of claims from past business while making new business more profitable.

10. For the future, the Chief Secretary recommends the measures summarised in paragraph 4 above, and places particular emphasis on the need to produce a Business Plan in 1986 that presents Ministers with a range of quantified options for the amount and distribution of risk they are prepared to accept in future. This in turn is linked closely to the proposals in the Management Review for portfolio management, which should help ECGD to attain the objective of encouraging exports within a break-even financial constraint. Since this could be crucial to ECGD's future performance, you may think it sensible for a report to be made on progress in developing the portfolio management approach in, say, 6 to 9 months' time.

Response to the Management Review Recommendations

11. The Management Review was conducted by a mixed team of management consultants (from Cooper Lybrand) and officials from ECGD, MPO and the Treasury. It recommended that a Board of external, part-time Executive Directors, under an outside Chairman, should be appointed to run the Department, and that the present Advisory Council - a statutory body set up to advise on ECGD's commercial business - be abolished. It recommended radical changes in ECGD's organisation and working procedures, to be implemented over 2-3 years, and increased application of information technology (IT). The changes in working methods proposed would lead to net savings of up to 500 posts. The Review also proposed changes in the grading structure, with annual increments in pay to be earned by all staff (rather than automatic) and exceptional performance rewarded by payment of more than one increment.

12. Mr Tebbit intends:

(a) to reject the Review's recommendation for a Board of external, part-time Executive Directors. He doubts whether this would be practicable and instead proposes filling two of the Under-Secretary posts by private sector ~~recruitments~~;

(b) not to abolish the Advisory Council now but to amend the statute when an appropriate opportunity arises;

(c) to implement the proposed changes in working methods and information technology, but over a 3-4 rather than a 2-year period;

(d) to accept the recommendations on a streamlined grading structure along with flexible pay arrangements;

(e) to encourage the development of portfolio management for handling political risk.

13. The Treasury are generally content with Mr Tebbit's approach. They may, however, question his reluctance to establish a Board of external part-time Executive Directors and his preference for filling two of the Under-Secretary posts by private sector recruitment. The issue is whether this is sufficiently radical to make a major impact on ECGD's attitudes. The Treasury are likely to agree to the flexible pay arrangements proposed, although they may propose some alternative means of achieving the same effect. You will no doubt, however, wish to leave the details of this, as also the question of whether ECGD should have a fifth Under-Secretary (there are 4 at present; the Review recommends 5), to be settled between Mr Tebbit and the Chief Secretary.

14. A point you may wish to probe is Mr Tebbit's proposal for a 3-4 rather than 2-year implementation period. Although 2 years always seemed ambitious, a 3-4 year timescale could lose some of the momentum of the Review, which ought now to be implemented as speedily as practicable if the necessary changes in ECGD's attitudes and financial and management practices are to be made. The longer the implementation period, the slower the benefits will accrue, and the further away the prospects of at least partial privatisation. On theother hand, the most sensitive aspect of the Review is the very large potential staff savings (up to 500 in total - 220 in Cardiff, 150 in Regional Offices, and 130 in London and Croydon). A 3-4 year timetable would give more time to absorb these savings, at the risk of some loss of the main impetus.*

* In his minute to you of 15 July the Secretary of State for Wales has drawn attention to the sensitivity of the possible job losses in Cardiff and the need to deal with this very carefully in any public announcement.

HANDLING

15. You will wish to invite the Secretary of State for Trade and Industry and the Chief Secretary, Treasury to present their papers. The Secretary of State for Foreign and Commonwealth Affairs may wish to comment on the foreign policy implications of what is proposed. The Secretary of State for Wales may have views on the implications for staff savings raised by the Management Review (since 220 of the 500 staff savings would occur in Cardiff).

CONCLUSIONS

15. You will wish the Sub-Committee to note:

(a) the financial position outlined in ECGD's Business Plan and its consequences for the PSBR;

(b) the action already taken to secure the profitability of new business and the need to keep the future of less profitable businesses under closer review;

(c) that developments in the source of export finance will not affect ECGD's role as guarantor;

(d) that no special arrangements will be needed for arms sales, but that the 1986 Corporate Plan will take account of the needs of that market.

17. You will wish the Sub-Committee to reach conclusions on:

(a) whether to endorse the definition of ECGD's role set out in paragraph 3 of E(A)(85) 46;

(b) whether ECGD's objective of encouraging exports should continue to be subject to the break-even financial constraint;

(c) whether ECGD should develop a system of portfolio management for handling political risk (as recommended by the Management Review) and provide in the 1986 corporate plan a range of quantified options for Ministers for the amount and distribution of risk they are prepared to accept in future;

(d) whether ECGD's interim objective should be to underwrite new business profitably, within existing market limits, subject to any agreed changes;

(e) whether to fill 2 of the ECGD Under-Secretary posts from the private sector or to accept the Management Review's recommendation for a part-time Executive Board; or some other solution;

(f) whether ECGD should press ahead with the changes in organisation and working methods recommended in the Management Review and on what timescale;

(g) whether to adopt flexible pay arrangements for ECGD, if necessary as a controlled experiment, subject to agreement on the details between the Secretary of State for Trade and Industry and the Chief Secretary.

18. You will also want to confirm the arrangements for announcing the Government's decisions. These are eagerly awaited in the City and Mr Tebbit will presumably wish to make an announcement to the House before the summer recess.

J B UNWIN
Cabinet Office
16 July 1985

PRIME MINISTER 15 July 1985

EXPORT CREDITS GUARANTEE DEPARTMENT

Peter Rees's paper points out that the cash deficit of ECGD will increase to £2 billion by 1990, with an annual addition to PSBR of some £300 million per annum. More pessimistic figures for developing countries would double the deficit.

Norman Tebbit supports the outcome of the recent management review, with two exceptions:

1. He does not agree with establishing a Board, but suggests recruiting two Under Secretaries from the private sector. This latter is a good suggestion, but is not a Board also needed to provide the guidance the department requires and to eliminate the "vacuum at the top" from which the department, according to the management review, suffers?

2. He suggests that information technology and improved working methods should be sought over four years and not two. This seems too long for a business in trouble, like ECGD.

We welcome the changes in rates on new business and the steps being taken to keep the future of less profitable business under review.

But we urge that:

a. The "vacuum at the top" should be addressed.

b. The reorganisation should be tackled with greater urgency. The business is, on a commercial basis, insolvent, and its bankers need not be too indulgent. Careful monitoring will be needed to see that the new business, which is expected to be profitable, realises this expectation. A banker would, as a minimum, put the business into "intensive care", with quarterly reporting, as an alternative to receivership.

The Treasury were rightly critical of the Bank of England's supervision of JMB. This is a case where bigger sums are at stake and management and its reporting system suspect. The Comptroller & Auditor General has qualified the accounts. The Treasury now has a chance to show its mettle and steer this problem business off the rocks.

David Hobson

DAVID HOBSON

CONFIDENTIAL

PRIME MINISTER

ECGD MANAGEMENT REVIEW

I have, today, seen the papers on this prepared by Norman Tebbit and Peter Rees. Neither paper mentions the point but the plan envisages that some 200 out of 650 ECGD jobs in Cardiff should go.

Rumour is already rife in Cardiff and Jim Callaghan has already raised the matter with me in the House. The papers for E(A) do not deal with the terms of any announcement of our decision, yet this is a matter of great importance for me. These proposals are a major political problem from my point of view appearing, as they do, to detract from our commitment to decentralisation in general and especially to Cardiff.

I spoke to Norman Tebbit last week setting out my concern and the issues which I think must be dealt with in any announcement. I shall be meeting Paul Channon tomorrow to discuss these points further but in the meantime I am circulating copies of my letter to Norman Tebbit so that colleagues may be aware of the points I shall wish to see considered.

Copies of this letter and its attachment go to members of E(A) and Sir Robert Armstrong.

15 July 1985

R N E

CT/7591/85

Y SWYDDFA GYMREIG
GWYDYR HOUSE
WHITEHALL LONDON SW1A 2ER
Tel. 01-233 3000 (Switsfwrdd)
01-233 6106 (Llinell Union)

Oddi wrth Ysgrifennydd Gwladol Cymru

WELSH OFFICE
GWYDYR HOUSE
WHITEHALL LONDON SW1A 2E
Tel. 01-233 3000 (Switchboar
01-233 6106 (Direct Line)

From The Secretary of State for Wal

The Rt Hon Nicholas Edwards MP

Dear Norman

10th July 1985

ECGD MANAGEMENT REVIEW

I have read reports about this review with some concern. Having now had the opportunity to study the document itself, together with reports by my officials of discussions with yours, it is quite clear to me that the review's proposals raise some serious difficulties from my point of view.

I fully appreciate the attractions of the more efficient and cost effective approach by ECGD to its operations set out in the report. But the loss of 400 - 500 jobs nationally and more particularly the loss of 200 posts (or even more) - almost a third of the establishment - in Cardiff, is clearly a matter of considerable sensitivity.

While I have no intention of arguing against necessary streamlining and while I am glad to note that the present proposals include implicit assurances about the continued presence of ECGD in Cardiff, I am concerned about the way in which they affect the Government's presence in Wales and in particular about the serious undermining of our commitment to dispersal of Government offices which can be read into them. The failure to carry through the MOD dispersal was strongly criticised but this plan, if implemented, would be seen as a clear reversal of the policy since jobs would be lost and some work (I understand) would be transferred back to London.

No-one could deny that Wales has borne its full share (arguably a greater than full share) of cuts in Civil Service jobs. My own Department has been reduced by some 15% since 1979 and there are job losses in prospect at the Driver and Vehicle Licensing Centre (500), in Jobcentres and Skillcentres (almost 100, despite the formidable pressures which our high levels of unemployment place on MSC facilities), in tax collection offices, the Ministry of Defence establishments at Crickhowell and Llangennech (almost 700), in a number of agricultural establishments such as the Plant Breeding Station (some 40) and quite probably in the Inland Revenue main office when PAYE is computerised. All this against a background where even the original dispersal of ECGD to Cardiff was on a considerably less generous basis than had been envisaged when the proposal first emerged and where even the reduced target of 700 jobs which I reluctantly accepted in 1983 has never been achieved.

/It is ...

The Rt Hon Norman Tebbit MP
Secretary of State for Trade and Industry

It is a particular blow to see this retreat to London by ECGD at a time when I am making major efforts to encourage the development of a financial service sector in Cardiff (the Chemical Bank is my first and main example to date), with modern technology making it easy to maintain excellent links with the City regardless of the distance between Cardiff and London. A move by ECGD to apply modern technology in Cardiff is wholly understandable but at the same time to return work to London could hardly come at a more inopportune time from the point of view of encouraging Cardiff's development as a centre of financial services.

I understand that you will be putting a paper to E(A) in the next week or so. I hope that you will take the opportunity which that paper offers to look at ways of mitigating the problems which implementing this review is likely to create. I think we have to seek a number of specific measures which will ameliorate the adverse effects of the plan and which can be announced at the same time as our decision on it. (Although I am not as yet clear when you propose to make an announcement).

I think that the following are the main points I would hope to see covered and which I hope we might be able to agree between us:-

1. that the new arrangements should be introduced in a phased way in order to minimise the number of compulsory redundancies and any industrial relations problems to which they might give rise - problems which are likely to affect other departments than your own;

2. that the new board or senior management of the department under the new arrangements should be instructed that their business plan must include a continued, major, viable ECGD presence in Cardiff for a reasonable period of time;

3. that we should look again carefully at the scope for bringing project-based ECGD work to Cardiff rather than centralising it in London;

4. that we should give high priority to looking for other parts of DTI (and indeed other Government activities) which might be decentralised to Cardiff and into the spare accommodation which may now become available;

5. that we identify the extent to which opportunities exist for re-deploying ECGD Cardiff staff amongst other Departments elsewhere.

I appreciate that time is short and, clearly, you will have thought of these points yourself. The matter is none-the-less one of some potential difficulty for me and I feel I must therefore register my concern before you reach firm conclusions. Perhaps we could discuss.

You may have seen Jim Callaghan raised the issue at Welsh Questions on Monday

Yours ever

Nick

21/76/27224

cc DH (Report with CF)

DEPARTMENT OF TRADE AND INDUSTRY
1-19 VICTORIA STREET
LONDON SW1H 0ET
Telephone (Direct dialling) 01-215) 5144
GTN 215)
(Switchboard) 215 7877

From the Minister for Trade

Rt Hon Peter Rees QC MP
Chief Secretary
HM Treasury
Parliament Street
LONDON
SW1P 3AG

11 June 1985

Dear Peter,

The team which I appointed last Autumn to review the management and organisation of ECGD has now reported. I shall be announcing the publication of the report in an arranged written PQ which I shall answer tomorrow.

The report, which I enclose, is detailed and I am not intending to make any comment at this stage. Norman Tebbit and I will be considering the report's recommendations and we shall submit our proposals to you and colleagues for comment in due course.

I am copying this letter, and the report, to the Prime Minister, Geoffrey Howe, Michael Heseltine, Timothy Raison and Grey Gowrie.

Yours,

PAUL CHANNON

999-3

ECGD MANAGEMENT REVIEW

CONFIDENTIAL

FCM

REPORT SUMMARY

1 In addressing our terms of reference, and identifying the future role of ECGD, we have analysed the Department's development through the post-war period and particularly the more recent years. Until the late 1970s ECGD experienced financial stability and a growing demand for its facilities. As a result, its business, which increasingly involved medium and long term risks, grew rapidly. At the beginning of the oil crisis of 1979, to be followed by the world recession, the Department had achieved a very high level of business and amounts at risk. Although premium rates, which had been halved over the last 20 years, had started to rise, income depended substantially on interest on the Consolidated Fund balance, which was to be eroded by a rapidly rising level of claims.

2 In the early 1980s political claims in particular rose dramatically and business levels fell - by a third in the case of short term business and by half for medium term business. These reductions were reflected in the decline in the percentage of exports insured.

3 The increased indebtedness of developing countries, and the reduced interest rate subsidies under the Consensus would appear to be the main reasons for the fall in medium term business. In the case of short term business a number of changes in the destination and composition of UK exports and greater concern with costs among exporters, would seem to have led to a larger number of exporters self-insuring, or insuring with the small but expanding private export insurance market.

4 It seems unlikely that any of the major factors will be materially reversed in the forseeable future, and the underlying prospect is for only limited growth in ECGD's business.

5 ECGD's exposure is concentrated on medium term commitments, and in relatively few countries. The Department's future financial

performance is overshadowed by the extent to which political claims will be recovered, and the timescale over which that occurs.

6 In considering the Department's future role, we assume that the level of medium term business, mainly related to political risk, will be determined within the potential market by Ministerial decisions about the support that should be given to capital goods exporters, and the political risks that the Department should accept. On the other hand, the Department should be able to run short term business on a broadly commercial basis, and the level of new business will be determined in part by the Department's ability to offer an attractive service to exporters. We have assumed that while Ministers will not want ECGD to compete aggressively against private sector insurers, they will want the Department to provide a high quality of service to exporters while meeting its "no net cost" objective.

Organisation of ECGD

7 The present senior management structure does not work effectively. There appears to be a vacuum at the top. With the prospect of a more difficult trading environment, and the need to carry through the considerable changes in working methods which we propose, we conclude that the Department should be headed by a Board, comprising 4 - 5 outside, part-time Directors (one of whom would be the Chairman), and the Secretary (to be designated Chief Executive). The Principal Finance and Establishment Officer would attend to advise the Board on resource matters. The Board would be responsible to the Secretary of State, through the Minister of Trade, for overall control and direction of the Department and its finances. It would put forward a Business Plan each year for approval by Ministers, and would set key tasks and objectives for the Under Secretaries based on the Plan approved by Ministers. Day- to- day management of the Department and implementation of the Board's Plan would be the responsibility of the Chief Executive.

8 Beneath the Board we propose 5 Under Secretary Groups (an increase of 1). Medium and long term business would be the responsibility of the "Project Group" (PG). The "Cardiff Group" would be responsible for the short term (less than 2 years' credit) facilities. The Group would be set rigorous short term financial targets, reflecting the commercial nature of short term business. Both Groups would be responsible for underwriting, claims and recoveries (the latter are currently the responsibility of the Principal Finance Officer) in order to bring together the market knowledge. This is important to ensure close cooperation between all the functions, and to clarify accountability for performance.

9 The Resource Management Group would combine the responsibilities of the Principal Finance Officer and the Establishment Officer to provide overall control of resources at Department level. The new Management Services Group would bring together information technology, a new O & M capability, economists, and OR staff. The International Group would amalgamate various functions associated with foreign debt and international negotiations and discussion on export credit and credit insurance.

10 The business of the Cardiff Group would be accounted for under Section 1, and the rest of the Department's business under Section 2, (apart from overseas investment insurance). The external Board members would carry out the statutory functions of the Export Guarantee Advisory Council in relation to Section 1 business. Charts of the present and proposed organisation of ECGD are at Annexes 1 and 2.

Financial Management

11 We recommend the introduction of new measures of financial management, involving a higher degree of decentralisation of the finance function while maintaining effective control by the PEFO. The annual Business Plan would become a key feature of planning and control, being the detailed expression of the Board's strategic

objectives. The Board would monitor key indicators to ensure that the Plan was being achieved. These changes would be supported by major improvements in the management accounts. Priority based budgeting and performance measures would be introduced wherever possible, supported by a new management information system. The aim would be to have financial and other objectives and clear areas of accountability throughout the Department.

Risk Management

12 The key to meeting ECGD's objectives lies in accurate assessment of risks. These fall into two broad categories, political and commercial. The latter is more easily controlled because the risks are mainly short term and spread over a large number of buyers; and we recommend that the Cardiff Group be fully accountable for the outturn on short term buyer risk business. The political risk is much more difficult to manage, because it is concentrated, and is largely related to medium term business. Here we recommend methods of portfolio management so that the financial consequences of the existing portfolio, and increases in it, can be assessed and incorporated in the Business Plan for decision by Ministers.

Effective Management

13 The future prospects for the Department, and particularly the successful implementation of our recommendations, will depend upon commitment and leadership by the senior management and more effective management at all levels. We make recommendations to improve the communication between management and staff and for the greater delegation of work within the Department.

Efficiency within functions

14 Alongside our recommendations for re-organising the Department we make a number of recommendations to improve the efficiency of the Groups. Generally we hope greater efficiency will be achieved by

decentralising functions and establishing clearer responsibilities and accountability. More specifically we recommend changes to short term underwriting and claims procedures which would increase efficiency and substantially improve the service given to exporters.

15 The Department's future efficiency is heavily dependent on improvement and expansion of the information technology facilities and the new Management Services Group will have a central role in developing the systems and providing the facilities throughout the Department. We recommend that an immediate task is a review of IT strategy.

16 We recommend that a study should be carried out of the Department's markets and products so that the Board can lay down a marketing strategy for the Department. Subject to these developments we have recommended that the Regional Offices should become considerably smaller. Our proposals on short term underwriting will reduce the amount of work carried out in the Regional Offices, as will a recommendation to centralise short term claims work in Cardiff.

Staff Management

17 Overall we have not found that the Civil Service rules are a significant hindrance to the businesslike operation of ECGD although there is a good case for flexibility in some areas. Nor have we found that ECGD has suffered exceptional losses of staff to the private sector. We do not see the need for a Departmental class.

18 The Department will need a wide range of professional and other skills to carry out the functions which we recommend. We do not find that the existing recruitment methods are inadequate, but we consider that there should be an increased number of secondments between the Department and other departments and private sector businesses.

19 There will be a major training need to provide the Department with the skills (including management skills) required.

20 With the changing nature of the work the Department should consider simplification of the grading structure. To provide a clear link between pay and performance, progression on incremental scales should be linked to performance markings under the annual appraisal system, and progression beyond the maximum pay point on the scale should be possible for HEOs and Principals making contributions beyond the requirements of the grade.

Conclusion

21 Our recommendations would change the Department from one based largely on clerical systems to one which is more analytical and more extensively computerised. It will be a substantially smaller Department, providing a better service for exporters, more interesting work for the staff, and we hope justifying higher status among other government Departments. The Department would be directed more effectively and the staff would know more clearly what is expected of them, and why their functions are important to the achievement of the Department's objectives. This appears to us to be the only basis on which the Department can be expected to perform successfully in a difficult and to some extent unpredictable future.

7/154/28184

CC NO

DEPARTMENT OF TRADE AND INDUSTRY
1-19 VICTORIA STREET
LONDON SW1H 0ET
Telephone (Direct dialling) 01-215) 5144
GTN 215)
(Switchboard) 215 7877

From the Minister for Trade

cc. ECON POL
Indebtedness
Parts

1) MT to see
2) NBPM
CDP
17/4

The Rt Hon Peter Rees QC MP
Chief Secretary to the Treasury
Parliament Street
LONDON
SW1

16 April 1985

Dear Peter,

In your minute of 3 April to the Prime Minister you outlined the steps you and I are taking to improve ECGD's financial position. At our meeting before this, we discussed the relevant merits of refinancing and rescheduling ECGD's overseas debts which are subject to Paris Club treatment.

My starting point is that we should seek to refinance wherever possible on the grounds that this achieves a real improvement in ECGD's cashflow and to the PSBR.

The underlying debt is unchanged, whether we refinance or reschedule, but I attach considerable importance to the presentational advantages of reducing ECGD's cash deficit as far as we can. And I would imagine that you would welcome the relief to the PSBR.

I mentioned at our meeting that there were two big ticket items where in my view refinancing ought to be considered. They are Nigeria and Poland. Nigeria cannot be a serious candidate at this stage in view of their failure to come to terms with IMF: indeed the future prospects are looking somewhat bleak and we have already agreed to revise our projections for ECGD's overall cashflow in recognition that there is now some risk of the Nigerians defaulting on their medium term liabilities in the not too distant future. But Poland is a good candidate and I should like it to be seriously considered since we shall very shortly be talking to the Poles about restructuring their 1982-84 debts. We have already agreed two refinancing loans for Poland and the structure of their 1982-84 debt is such that a further refinancing would be relatively easy to arrange. Moreover, the amount (£486m) is substantial.

I understand, however, that Treasury officials have reservations about a refinancing deal for Poland, mainly on the grounds that their economy is so weak that there must be serious doubts as to whether they will be able to service a new loan over the term already agreed in the Paris Club. I cannot, however, see that this is relevant to the issue of whether the Polish debt should be refinanced or rescheduled. I regard both techniques as of equal merit and I cannot see that the risk of a further rephasing of the terms of the loan should preclude the granting

of that loan. If the situation is so bad that we believe the Poles will be unable to pay on the agreed dates then we ought not to be going along with the Paris Club agreement in its present terms.

If on the other hand there are problems in relation to the monetary effects of a refinancing loan then of course we should have to take account of them. but in the absence of any compelling Treasury counter arguments I should like to authorise ECGD to identify the most appropriate refinancing technique and to invite tenders from the bankers.

I should welcome an early reaction since there is not all that much time to do this ahead of the bilateral discussions due to take place at the end of April or early in May.

I am copying this letter to the Prime Minister, to members of EA and EX and to Sir Robert Armstrong.

Yours,

PAUL CHANNON

Paul

Trade In 80

ECG



file DA

10 DOWNING STREET

From the Private Secretary

15 April 1985

Dear Richard.

ECGD's Finances

The Prime Minister has seen the Chief Secretary's minute of 3 April about the report which is in preparation on ECGD's finances. The Prime Minister agrees that it makes sense to await the conclusion of the Management Review before submitting the report. She is content, therefore, with a target of discussion by EA in early July but would not wish it to slip beyond this.

I am copying this letter to Private Secretaries to members of EA and EX and to Richard Hatfield (Cabinet Office).

Yours ever

Charles Powell

(Charles Powell)

Richard Broadbent,
HM Treasury.

887

005/111

Prime Minister CDO
Agree to some further delay?

FROM: CHIEF SECRETARY
DATE: 3 April 1985

CDO 13/4
Yes - no option

PRIME MINISTER

ECGD'S FINANCES

At a meeting of EX on 13 February I was asked, in consultation with the Secretary of State for Trade and Industry, to report to EA on ECGD's finances. The background was ECGD's serious financial position, in particular the cash deficit which on the most recent assumptions including gloomier prospects for Nigeria, will rise to almost £2 billion by 1989-90 imposing a heavy burden on the PSBR, reflecting the effects of the international debt problem on business taken in the past, and the wide margin by which on present projections the Department will fail to meet its financial targets set only last year. During the period up to 1989-90, ECGD's reserves should remain positive assuming that all the overseas governments which had to restructure their debts ultimately repay them with a reasonable rate of interest.

2 I had hoped to be able to make this report about now on the basis of ECGD's first full Business Plan. However, the Plan is not yet ready and ECGD are approaching the end of a wide ranging Management Review which has been looking at ways of making ECGD more business like within its present status as a Government Department. I understand the Review will report radical conclusions towards the end of this month. In these circumstances, a limited further postponement would allow the Plan to cover not only the improvements in ECGD's finances which might be sought within the present arrangements but also those flowing from any changes in organisation and objectives recommended in the Management Review and in the other work which ECGD have in hand on greater use of the private sector. This would provide a better basis for a full EA discussion of ECGD's finances and, subject to your views, Paul Channon and I believe that we should work on this basis towards an EA discussion very early in July.

3 Meanwhile, Paul and I have considered whether there are any immediate decisions which might be taken to improve the Department's financial health. We believe that business now being underwritten by the Department should be required to pay its way. Much of it does, although there are a few loss making facilities which are effectively being cross-subsidised. We are in touch about the extent to which this is tolerable or whether these facilities should be closed down and about the extent to which ECGD's premium rates should be increased to bring the Department closer to the achievement of its financial target. I will report the outcome of our discussions in due course and any disagreements can be exposed in the course of the Review by EA.

4 I am copying this minute to members of EA and EX and to Sir Robert Armstrong.

PETER REES

FILE 84

EX: FCO
HMT
DTI
(+CO)

10 DOWNING STREET

From the Private Secretary

8 November, 1984

ECGD

The Prime Minister has seen the exchange of correspondence between Mr. Channon, the Chancellor of the Exchequer and the Foreign Secretary. She is content with the direction in which it is proposed to take further work on ECGD.

I am copying this letter to the Private Secretaries to members of EX and to Richard Hatfield (Cabinet Office).

ANDREW TURNBULL

Steve Nicklen, Esq.,
Department of Trade and Industry

CONFIDENTIAL

BM.

CONFIDENTIAL

FCS/84/287

MINISTER OF TRADE

1. Thank you for sending me a copy of your letter of 15 October to Nigel Lawson about the recommendations of the Matthews Committee on ECGD.

2. I agree with the course of action you outlined and see that in his reply of 26 October, Nigel Lawson is generally content with what you propose.

3. I have one point to add. As you say, it is important that closer collaboration should not result in a worsening of the quality of ECGD's risk portfolio. Nigel Lawson has suggested that ECGD should consider the types of business and risks where the private sector might provide more cover and where ECGD insurance might be withdrawn. In doing that, I hope great care will be taken to avoid steps which would diminish ECGD's scope and ability to provide cover on contracts involving the national interest.

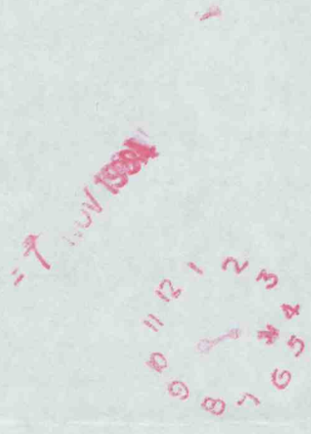
4. I am copying this minute to the Prime Minister, to other members of EX and to Sir Robert Armstrong.

GEOFFREY HOWE

Foreign and Commonwealth Office

7 November, 1984

TRADE: ECGD Jan '80



MR OWEN

This is just to record that the Prime Minister saw the note prepared by yourself and David Hobson about the ECGD. She was not attracted by the suggestion that there should be a Board of the kind you propose on the grounds that she did not believe it would work. In these circumstances she did not wish to intervene in the correspondence between Paul Channon and the Chancellor.

TIM FLESHER
1 November 1984

CONFIDENTIAL

~~PP's please~~

Prime Minister:

Agree that Policy Unit suggestion should be put to DTI and the Treasury

31/10

MR TURNBULL

31 October 1984

ECGD

The Chancellor has now responded to Paul Channon's letter on the Matthews Report.

We share the scepticism about the Matthews recommendation that ECGD should be replaced by a Corporation, but it is disappointing that, after another round of discussions, we seem no nearer to resolving the question: how can ECGD be run more commercially? To find the answer, a third round of work is now proposed. We suggest that it be steered towards the right answer: the appointment of an independent Board capable of resisting departmental pressures to provide cover beyond prudential limits.

We suggest that the Prime Minister should intervene at this point to suggest that the managerial review should be specifically directed to consider establishing an effective Board, with an independent Chairman of standing, and with powers to take policy decisions, in place of the existing Export Guarantees Advisory Council. This might help to provide the measure of independence from departmental pressures that ECGD badly needs.

David Hobson

DAVID HOBSON

Nicholas Owen

NICHOLAS OWEN

I do not think this will work

MT

CONFIDENTIAL

2.37

CONFIDENTIAL

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

26 October 1984

The Rt Hon Paul Channon MP
Minister for Trade
Department of Trade and Industry
1 Victoria Street
LONDON SW1

Dear Paul

Thank you for your letter of 15 October setting out the lines which you and Norman Tebbit propose to take in response to the recommendations of the Matthews Committee on ECGD.

On the principal issue - turning ECGD into a public corporation - I share your scepticism. The recommendation failed to take full account of important financial considerations, in particular the need for the Exchequer to continue as the ultimate guarantor and hence for controls over the enormous contingent liabilities involved and also the public expenditure and resource implications. It would certainly not provide an easy route to a more commercial approach.

However I fully accept your view that managerial and operational improvements are needed in order to give ECGD a more commercial outlook, within the framework of its present departmental status. I should therefore be happy to see the review you propose go ahead with the terms of reference attached to your letter. I attach particular importance to the review examining ways of bringing private sector attitudes to bear on the Department's business in a continuing way. The present Advisory Council's remit is far too narrow for this purpose.

Your letter also raised two other issues. On relations with the private sector, I agree that this needs further investigation and tht ECGD should be asked to explore and report back on the various issues in this area. However, I believe their terms of reference should go wider than simple collaboration, which may simply lead to suggestions that would require the Exchequer to stand behind the private sector. They should be asked to identify the types of business and risks where the private sector could be expected to provide more cover and to consider the possible withdrawal of ECGD insurance in particular areas.

I also agree that the Treasury, in consultation with the Bank of England, should take the lead in pressing on with active

TRADE : ECGD Jan '80

CONFIDENTIAL

consideration of the idea of a private sector export bank. My officials have already had a number of informal talks with some of the institutions who have shown an interest. I suggest they should now take these forward more formally.

Subject to views of other colleagues, I am content with your proposal for an early statement to Parliament by Written Answer. No doubt your officials will clear the terms of that with mine.

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

NIGEL LAWSON

Prime Minister (2)
To note direction DTI wish to go on ECGD

DEPARTMENT OF TRADE AND INDUSTRY
1-19 VICTORIA STREET
LONDON SW1H 0ET
Telephone (Direct dialling) 01-215) 5144
GTN 215)
(Switchboard) 215 7877

16/10

From the Minister of Trade

CONFIDENTIAL
MANAGEMENT IN CONFIDENCE

15 October 1984

Rt Hon Nigel Lawson MP
Chancellor of the Exchequer
HM Treasury
Parliament Street
LONDON
SW1P 3AG

Dear Nigel.

Under cover of my letter dated 17 September 1984 to Peter Rees, I circulated the report by officials on the recommendations of the Matthews Committee on ECGD.

2 In discussion, we have agreed a course of action for which I now seek agreement from you and other colleagues primarily concerned.

3 The main recommendation of the Matthews Committee was that ECGD should be replaced by a Government-owned corporation performing broadly the same functions as ECGD. Norman Tebbit and I are sceptical about this proposal, the prospective benefits of which are far from clear, either for the export trade or for HMG. Indeed there is a danger that such a corporation would provide a more expensive and poorer quality of cover than ECGD, with no certainty that it would be more efficient.

4 To the extent that Matthews was trying to make ECGD more businesslike, I should prefer to seek managerial and operational improvements within the present framework, rather than making radical changes which would involve, inter alia, opposed primary legislation. I therefore support the proposal of a quick managerial and staffing review conducted by officials, but assisted by one or two outside consultants. Suggested terms of reference are annexed to this letter.

5 There are however two broader issues arising from Matthews which need to be followed up. The first concerns relations with the private sector. Matthews briefly dismissed the notion of privatisation, largely on the grounds that private sector involvement in export credit insurance, though growing, is still very small. Nevertheless, there may be some scope for encouraging the private market through closer collaboration with ECGD e.g

JH1BBC

through co-insurance or re-insurance arrangements. It is important that any such moves should not have the effect of worsening the quality of ECGD's own risk portfolio - which could have adverse repercussions on the cover given to the export fraternity at large; but the scope for collaboration needs to be investigated further than Matthews was able to carry it and, if you agree, I will ask ECGD to embark on serious discussions with those companies in the private sector which would be interested in collaboration.

6 Second, Matthews suggested that his proposed corporation should have the ability to raise its own funds. This thought was not developed, but it does lead into the possible need for an export bank. This is a topic that has been aired in the past but for various reasons has not been pursued. However, I know that a number of institutions in the City are getting interested in the scope which an export bank (with or without a Government holding) might afford for tapping cheaper long-term sources of export finance, and this is a subject which the Treasury and/or the Bank of England could perhaps study in more detail.

7 I am copying this letter to the Prime Minister and to colleagues on EX, as well as Sir Robert Armstrong. Subject to any comments which you or they may have, my intention would be to make an early statement to Parliament of the action we are taking — Probably by written Answer.

Yours,

PAUL CHANNON

Paul

JH1BBC

ANNEX

"To consider the scope for change in the management of the Department, without resort to a change in status and having regard to the tasks which ECGD is required to perform, and to make recommendations with particular reference to:

1. The organisation and staffing structure of the Department as a whole

2. The top management structure in particular

3. The role of the Export Guarantees Advisory Council

4. The need for specialist skills and knowledge in key areas

5. The methods of recruitment and training

6. The grading and remuneration structure".

JH1BBK

CONFIDENTIAL

B/F ... CST's response

1 October 1984

MR TURNBULL

ECGD: MATTHEWS REPORT

Mr Channon has written to the Chief Secretary on the inter-departmental report on the Matthews proposals.

The consensus appears to have emerged that the formation of a Corporation to take over ECGD, as suggested by Matthews, has a number of drawbacks, including the requirement for contentious primary legislation without the possibility of effective privatisation. In these circumstances, we think ECGD should be left as a separate department.

We agree that the proposed management study should proceed and that, following this, measures to improve staffing and administration of the department need to be considered.

However, the financial position and control of ECGD give grounds for concern in that:

a. ECGD has very large commitments which can have a significant effect on the PSBR if things go wrong.

b. There is expected to be a negative cash flow in sterling over the next 3 years of the order of £300m per annum.

CONFIDENTIAL

c. There is uncertainty as to the amount needed to provide for doubtful overseas debts, which is under discussion with the C&AG, who is said to be reluctant to endorse the accounts without further provision. There is some similarity to the position of commercial banks lending to the Third World.

d. Pressure is exercised on the ECGD by its sponsoring department, and others including FCO and Defence, to accept some large risks which the department is unwilling or reluctant to take on within the existing guidelines, as constituting excessive amounts of risky business, possibly at inadequate premiums (eg Tornados for Turkey).

e. The staffing and administration areas have given rise to problems, especially the recruiting of sufficient specialists, leading to complaints about the standard of service to industry.

We suggest that the Chancellor of the Exchequer should be asked to consider whether the suggestions put to Ministers provide for sufficiently firm financial control over the department and, if not, suggest how best to exercise and achieve this.

David Hobson

DAVID HOBSON

Treasury Chambers, Parliament Street, SW1P 3AG

cc: EST
Sir P Middleton
Mr Bailey
Mr Littler
Mr Unwin
Mr Monck
Mr Kemp
Mr Montfield

Mr Scott-Battett
Mrs Case
Mr Lord
Mr Ridley

28 September 1984

Rt Hon Paul Channon MP
Minister for Trade
Department of Trade and Industry
1-19 Victoria Street
LondonSW1H QET

MATTHEWS REPORT ON ECGD

Thank you for your letter of 17 September setting out your first thoughts on the report by officials on the follow-up to the Matthews Report.

2 As your letter recognises, I will be very heavily engaged on the public expenditure round over the next few weeks and I note that you want to make an early announcement to Parliament. Given that you seem generally to accept the recommendations from officials, I do not want to hold up consideration of the report and Trade Ministers' views by our colleagues and would therefore be happy for the report to be circulated to EX without any preliminary consultation with me.

3 Your letter also mentions the idea of an additional Under Secretary post for the Department. I understand that there has been some discussion about this between our officials. The right course seems to be for the Secretary of ECGD to put forward the case as quickly as possible. We will of course bear in mind the point you make about our public response to the Matthews Report.

PETER REES

CONFIDENTIAL
MANAGEMENT IN CONFIDENCE

TRADE: EC6D Jan 80

8 OCT 1984

J562

CONFIDENTIAL

MANAGEMENT-IN-CONFIDENCE

B Fwd to PM response AT 18/9 CC PO.

010

DEPARTMENT OF TRADE AND INDUSTRY
1-19 VICTORIA STREET
LONDON SW1H 0ET
Telephone (Direct dialling) 01-215) 5144
GTN 215)
(Switchboard) 215 7877

From the Minister for Trade

The Rt Hon Peter Rees QC MP
Chief Secretary
HM Treasury
Parliament Street
London
SW1P 3AQ

17 September 1984

Dear Chief Secretary

MATTHEWS REPORT ON THE ECGD

Attached is a report by an inter-departmental group of officials which considers the implications of a recommendation by the Matthews Committee that ECGD should be turned into a Government -owned corporation. Ministers now have to decide what should be done with a view to an early announcement to Parliament. However, before Norman Tebbit writes to you and other colleagues in EX with this Department's formal views, I thought it might be worth my giving you our first thoughts.

In opting for a Corporation run on "commercial" lines, Matthews was seeking a greater clarity in objectives and accounting, including much sharper distinction between insurance which is justifiable against commercial criteria, and that provided in the national interest. He also saw the Corporation with its capital structure and commercially motivated board as a means of injecting a more business-like approach into ECGD's organisation and management.

It seems clear that Matthews' objectives are desirable and we could implement his recommendation. Against this, the change would require primary legislation, which would be opposed, and difficult financial and operational issues would have to be settled. These include capitalisation (with important implications for Public Expenditure), the functions, staffing, and the relationship with Government. Thus the process of change would be extended and painful. Moreover, there may be some danger that a Corporation with a tight commercial mandate, coupled with power to re-insure with HMG, and a free rein on staffing would provide a poorer range of cover at greater expense than ECGD.

CONFIDENTIAL

MANAGEMENT-IN-CONFIDENCE

It may be that there is enough scope for change within the present framework. ECGD's response to the Financial Management Initiative will go a long way towards meeting Matthews points about clearer objectives and accounting. The managerial issues are perhaps less tractable, not least because Matthews himself was not very specific about them. Those commentators - and there are many - who support Matthews, are equally vague, apart from pleading in a generalised way for greater flexibility - by which they all too often mean bigger and better cover in the riskier markets, i.e. looser financial objectives. There are however many who feel that ECGD has had a raw deal in the past in a variety of staffing issues, as a result of Government intervention in numbers, grades, and location of manpower, without adequate regard to the needs of ECGD's customers.

I understand that officials in the MPO and Treasury are willing to consider any special managerial/staffing needs in ECGD provided they are adequately identified and articulated. To enable this to be done it seems to me that we need a small team of officials together with one or two outside consultants to look in more detail than Matthews was able to do at the tasks ECGD is undertaking, and the ideal arrangements for recruiting, motivating and retaining staff of the necessary quality to discharge those tasks. In short, I would go along with para 33 of the note by officials.

I am attracted by the idea of a mixed public/private sector team to look into ways of encouraging the private sector to play a greater role in export credit insurance and finance. I am afraid to say that I agree with the report that privatisation as such is clearly a non-starter at present but it should be possible to develop the banks' schemes for covering smaller exporters, and there could well be scope for collaboration between ECGD and the burgeoning private sector insurers. One way of pursuing this would be to co-opt into ECGD's management, perhaps on a part-time basis, a private sector individual with relevant experience, with a specific remit to explore the possibilities. I also believe that we should set up a joint public/private sector working party to examine the possibility of an Export Board largely owned by the private sector but which might have a minority government or Bank of England involvement.

At the same time I suspect there is a case for some permanent strengthening of ECGD's top management, perhaps by the restoration of an Under Secretary post which was lost from the establishment some 4 years ago. A great deal has happened since then particularly in the context of third world debt problems and their impact on ECGD's activities, and I am sure that it would be helpful, if in announcing whatever our decision turns out to be on Matthews', we were able to point to some strengthening at the

CONFIDENTIAL

MANAGEMENT-IN-CONFIDENCE

top, possibly by filling the Under Secretary post from outside.

I should like to discuss your views on my proposals. I am returning from an overseas visit in early October. I understand that you hope to be free from the diary constraints imposed by the PES bilaterals by then. Perhaps we could meet during the first week of the month?

Yours sincerely

S. Nicholls

for PAUL CHANNON

cc PS/SoS
PS/Sir Anthony Rawlinson
Mr Gill ECGD
Mr Roberts
Mr Hutton OT2
Mr Kemp ECGD
Mr Ranson ECGD
Mr Chapman PEP3
Miss Neville-Rolfe PEP2 (or)

External
Mr Raison
Ex Members
Sir R Armstrong

CONFIDENTIAL

ECGD - IMPLICATIONS OF THE REPORT OF THE "MATTHEWS COMMITTEE"

Note by officials

SUMMARY

1 Matthews recommended that ECGD should be turned into a State-owned corporation. The pros and cons were not argued out in detail. Officials have considered the implications and now seek a steer from Ministers.

2 Officials accept Matthews' view thatthere is no scope for privatisation, but that efforts should be made to encourage the private sector to play a greater part in export credit insurance.

3 The arguments for providing Government backing through a corporation or (as at present) a Government Department are not clear cut.

4 A change to a corporation would involve primary legislation, which would be opposed. There would be very difficult issues of finance, organisation, control, and relationship with Government to be resolved. The transitional costs could be severe; the benefits uncertain and longer-term.

5 The present arrangements work well on the whole. Criticisms are in many cases misguided and strike at ECGD's financial objectives as much as its operational procedures.

6 The alternative to a corporation is to identify more precisely and to try to deal with legitimate criticisms within the present framework. ECGD's response to the Financial Management Initiative will go a long way towards clarifying financial objectives and responsibilities. The remaining problems relate to managerial and staffing questions which maybe be soluble at least in part by introducing more flexibility into the present arrangements eg by the creation of a special Departmental grade of underwriters and the introduction in appropriate cases of performance-related pay. If Ministers prefer this approach rather than the creation of a corporation a detailed study of staffing and organisation led by ECGD and involving civil service and outside expertise is recommended.

7 Independently of the decision on Matthews, the case for the creation of an export bank deserves further, separate, study.

INTRODUCTION

8 In August 1983 a small committee chaired by Sir Peter Matthews (then Chairman of Vickers), assisted by Mr Leslie (Barclays Bank) and Mr Bevins (Royal Insurance), was asked to review ECGD's structure, functions and status, taking into account the corresponding facilities available to foreign competitors; the interests of the taxpayer; and the scope for devolving any functions to, or collaborating with, the private sector.

9 The committee took evidence from a wide range of interested parties and its report was delivered in March 1984 and published. Appendix A reproduces the summary and principal recommendations, the most far-reaching of which is that ECGD should be replaced by a government-owned corporation performing broadly the same functions and reinsuring some risks with HMG. In general the recommendations reflect the main weight of the views expressed in evidence.

10 Officials from the Departments chiefly concerned (ECGD, DTI, Treasury, MPO, FCO) along with the Bank of England and the policy unit in No 10 have studied the implications of the report from the points of view of financial structure, staffing and management, trade policy, and export finance. Their reports together with notes on the activities of the private sector and on credit insurers in other countries are listed at Appendix B. This paper draws on their findings and seeks ministerial guidance on Matthews' central recommendation. An early decision in principle is desirable to help dispel the uncertainty and anxiety which now overhangs ECGD's staff and activities, and to give officials an appropriate focus for any further work which may be necessary.

BACKGROUND

11 ECGD was set up in 1919 to promote exports. Its services have continually expanded and become more sophisticated, most rapidly since the 1950s. The heart of the business is a self-supporting export insurance scheme covering traders and bankers against bad debts. Such insurance gives exporters more confidence in expanding their trade; helps to reduce their costs by limiting the provisions they need to make for bad debts; and encourages the banks to provide competitive export finance. Premiums are charged, with the aim of covering claims and administrative costs. The Exchequer stands behind the scheme in case of need and is currently funding a temporary cash flow deficit, at appropriate interest rates. Insurance is given either on a "commercial" account, after consulting a statutory Advisory Council of businessmen and bankers, or on a "national interest" account by agreement among Whitehall Departments (in a number of cases involving reference to Ministers). All guarantees are given in the name of the Secretary of State.

12 The scale of ECGD's insurance business is very substantial. Some 30% of UK non-oil visible exports are insured and total exposure under all guarantees exceeds £40 billion. There are 1,800 staff: 1,400 at headquarters, split about equally between London and Cardiff, and 400 spread among 9 regional offices.

13 Apart from its insurance business, ECGD handles two public expenditure programmes; an interest support programme for exports on medium and long term credit, and a facility for rapid matching of other countries' aid-supported exports on individual deals. The former has entailed significant expenditure (£329 million in 1983/84) but this is expected to reduce to zero by 1988. Until March 1984 there was also a programme for covering exporters against cost inflation.

14 Over its 65 years of existence ECGD has succeeded in paying its way on the insurance account, though the weight of third world debt now hangs heavily over future performance and has already caused a cash flow deficit expected to last for a further 3-4 years.

15 The UK was probably the first country to create a state scheme for export credit insurance and has since led the way in expanding the range and quality of its facilities. Other countries have followed suit, and there is a wide diversity of national institutions, both in status and range of activities. All have some government backing and are subject to government control on policy matters. There is no obvious paradigm.

PRIVATISATION

16 A few private sector credit insurers and Lloyds operate in the export arena but the market in the UK, though expanding, is fragmented and specialised and totals less than 5% of ECGD's volume. The Matthews Report briefly dismisses the prospects for privatisation. However officials have examined more closely various options (Appendix C). Historically the private insurers have shown relatively little interest in exports. Indeed, ECGD owes its origin and development to the absence of a significant private market in export credit insurance. As in other countries, the UK private insurance sector is not at present interested in small transactions or small exporters - which it regards as uneconomic; or in longer term risks or political risks on payments (eg a new government repudiates

its predecessor's debts, or a country runs out of foreign exchange) - which it sees as too large and uncertain. Consequently the range and quality of its cover stand little comparison with ECGD's. The private market itself disclaims the capacity or the appetite at present to expand significantly. Overall we see no reason to challenge Matthews' conclusion that significant privatisation of ECGD's functions is not a credible option at this stage. Given the need to retain support for exports comparable with that given to the competition, no present alternative can be seen to maintaining something like the existing level of public sector support.

17 The more pertinent question is how the private sector, including the banks, can best be encouraged to play a more significant role in the longer term, in both fair competition and collaboration with ECGD. Joint insurance and reinsurance are the norms in the private sector. The wider use of these techniques by ECGD, coupled with a continuing review of the boundary between private and public sector involvement in both export insurance and finance, would appear to be the best way to encourage the private sector to widen its scale of operation. It might also offer some possibility for ECGD to reduce its numbers in future by concentrating on a more "wholesale" role. This process should be undertaken regardless of the status of ECGD: Matthews implies that it would be easier if ECGD were a corporation with a commercial style rather than a government department, but there is no obvious reason why a change in status should be necessary if ECGD were given a clear mandate and the necessary resources to collaborate with the private sector. As a first step we recommend the setting up of a joint public/private sector working party to explore the practical possibilities. Its terms of reference should require it to identify those types of business and risks for which the private sector could best be expected to provide more cover; and to examine what techniques would encourage them to do so, including co-insurance and re-insurance with ECGD, the possible withdrawal of ECGD insurance in particular areas and the sharing of information.

EXPORT FINANCE

18 Arrangements for the provision of export finance are largely independent of the arrangements for export credit insurance. At present finance in sterling and some other major currencies is drawn almost exclusively from the banks. In the case of medium and long term business they lend at internationally agreed fixed "consensus" interest rates, but HMG, acting through ECGD, pays them (or receives from them) any difference between these rates and their short term borrowing costs plus an agreed margin. The Matthews report recommends against any major change in the system, although it proposes that ECGD should be able to lend directly in certain (unusual) circumstances, and that encouragement should be given to the development of sources of finance independent of government. However it did not review the alternatives in detail.

19 Two broad alternatives to the present system are possible. The first would be for the government itself to provide medium and long term export finance which would undoubtedly enable funds to be raised more cheaply than under the present system but would score temporarily against the PSBR and public expenditure. The second would consist in the creation of an "export bank" which would be largely owned by the private sector but which might have a minority government or Bank of England shareholding: this would avoid the PSBR and public expenditure problems, and minimise the need for over funding, but would be less attractive to the banks than the present system. The second of these alternatives should certainly be explored, whatever is decided about Matthews' main recommendations. Again a joint public/private sector working party would be appropriate for the purpose. The case for considering direct provision of finance by government is less clear cut, but it might usefully be studied by officials and the Bank of England at the same time.

FACTORS RELEVANT TO ECGD'S STATUS

Characteristics

20 The organisation and status of ECGD must pay regard to the tasks required to be performed. There being no scope for substantial privatisation in the near term, the key question is whether those tasks will be more effectively and efficiently discharged by a government department (as at present) or by some other state-backed body. A starting point for consideration might be the main characteristics necessary for the required organisation to be fully effective. We would describe these characteristics as follows:

A. Unqualified Government financial backing; proximity to Whitehall and Ministerial thinking on trade and foreign policy matters and other related issues; practical arrangements for taking account of the national interest; and easy access to privileged market information.

B. Clear financial objectives, with necessary controls to safeguard the public purse, coupled with monitoring procedures over the outturn of a wide range of business, to identify and minimise loss-making facilities and avoid unjustified cross subsidisation.

C. A close relationship with customers (exporters and financing institutions) to allow quick responses to their needs, consistently with the financial and other business objectives; and interaction with private insurers, to promote private sector participation.

D. Efficient management and deployment of resources at the operational level. In particular management should be free to acquire, organise, and locate the resources of

personnel and machinery, including new technology, strictly in accordance with the needs of the market place, to provide customers with the service they deserve for the premiums they pay.

The Present Arrangements

21 The present arrangements show many of these characteristics. ECGD has enjoyed a high reputation at home and abroad as a pioneer in its own field. The advantages of its government department status should not be undervalued: Exchequer backing is clear and unambiguous; the structure of accountability within Whitehall and to Parliament is well understood; there is easy access to government information on overseas markets; the Department has developed and operated in the context of overall trade policy. Its objectives of encouraging trade without cost to the taxpayer on its insurance accounts have been achieved for over fifty years. The wide range of facilities has enabled some of less certain financial value to be carried without incurring international criticism.

Criticisms

22. Many of those who gave evidence to Matthews, whilst appreciative of ECGD's services, nevertheless felt that the present arrangements fell short of the ideal. Criticisms were varied but the most frequent related to alleged "inflexibility", and slowness of response. The critics tended to associate these shortcomings with undue interference by Government in day to day management. The split of ECGD's headquarters between London and Cardiff, as part of dispersal policy at the time, is the most often quoted example of such interference, with arbitrary staff cuts mentioned nearly as often.

CORPORATION STATUS?

Management Issues

23 In recommending a change of status for ECGD, the Matthews Committee themselves were unable to point to any one overwhelming argument, but referred to "a number of factors which all point in the same direction". These factors appear to revolve round the perceived

need for greater managerial freedom, a desire for more transparent accounting, and a sharper distinction between "commercial" and "national interest" business.

24 However the arguments for change are by no means clear-cut. In particular, the criticisms of ECGD need to be analysed with some care. Many allegations of inflexibility tend to boil down to a plea for greater risk taking at the taxpayer's expense, and thus amount to a demand for a looser financial objective, which Ministers if they so wished could agree within the present Departmental arrangements. On the accounting side, greater clarity of objectives and more rigorous accountability are very much in line with the Government's financial management initiative and with pressures to improve public accountability but Matthews may have ignored the fact that internationally, a degree of opacity in published accounts may on occasion be to the UK's advantage. Moreover, a corporation on the lines suggested by Matthews, with a capital structure to service, could well find itself providing a more efficient, but a narrower and more expensive service than ECGD. On managerial issues, where Matthews' and other criticisms might carry greater weight, the transitional problems of a change of status (which would be opposed by the Unions) may have been underestimated, and any efficiency gains would only be reaped over the longer term. However, the Matthews report did not specify the managerial changes which were needed.

Financial and organisational Issues

25 A decision to opt for a public corporation with Government backing would require primary legislation, which would be opposed, and would raise fundamental issues of finance and organisation (Appendix D). Some difficult questions of competition policy would also arise. Matthews assumed that a Corporation could retain the ultimate backing of the Exchequer but operate on a day to day basis with greater commercial freedom than ECGD now has. But if the Government were the ultimate guarantor, it could not give the Corporation a completely free hand. We observe that, whatever the

status of credit insurers in other countries, some of whom are corporations, they have little freedom over policy.

26 The costs and benefits of a public corporation compared with the alternative "departmental" option depend on decisions about four interlinked issues:-

(i) the nature of the "reinsurance" arrangement between HMG and any corporation;

(ii) the nature of the underlying guarantee given by the Government to the Corporation's own account business (ie that not reinsured);

(iii) the size of the capital base needed to support the operation; and

(iv) the nature of the controls which would be needed given that the Government is the ultimate guarantor and owner and the provider of funds to support export finance at fixed interest rates.

27 A number of alternative structures could be devised. The limiting cases are probably those of

(a) a corporation with a purely commercial remit ie business limited to buyer risks and "good" political risks. A corporation on these lines would be smaller than ECGD with a small capital base. Even so, it would be unable to dispense with a Government guarantee completely and this would detract from a fully commercial approach. The arrangements for division of risks could be distinct and well defined, making for clearer accountability. This would be the logical choice if privatisation was the ultimate objective. The remaining business covering the more obvious risks, would fall to the Government's account. The corporation would handle these on an agency basis but a sizeable

establishment in the sponsor Department would be needed to carry out country risk analysis and underwriting;

(b) a large corporation taking almost all the risks now underwritten by ECGD. Making the maximum use of the corporation's resources in this way would reduce the need for duplication of effort within Departments. Such a corporation would however need a very large capital base and/or a more explicit Government guarantee. The more open-ended nature of its risk portfolio would require a different form of supervision by Government and appropriate departmental staff for this purpose.

In no conceivable case would a corporation be able to take on to its own books the full range of risks currently carried by ECGD. If Ministers wished in the national interest to support risks considered unacceptable for the corporation's own books, some split of the work and of responsibility between the corporation and the Government is inevitable.

28 Whatever alternative for the split of risks and responsibilities between Government and corporation were adopted the central issues would remain the same:

(a) the basic contradiction between Government backing (and protection from bankruptcy) and a truly commercial approach;

(b) the need for controls to protect the Exchequer and taxpayer as ultimate guarantor and the consequential limitations on management's freedom of action;

(c) the immediate PSBR and public expenditure cost of endowing the corporation with a capital base;

(d) the extent of any improvement in financial discipline and public accountability;

(e) the extent of duplication between Government and corporation arising from decisions on Government account business and supervision of total contingent liabilities;

(f) the extent of any improvement in efficiency of service to the exporter;

(g) the possible contribution to the development of the private sector.

Matthews' Recommendations

29 Altogether a change to a corporation is a feasible, but by no means easy, option. The less tangible gains looked for in terms of improved efficiency, financial discipline and service to exporters would need to be weighed against the certain cost of dislocation caused by change, of the capital base endowment, and of the split of responsibility and effort between corporation and Government. The judgement to be made is whether the alleged weaknesses in the present system which need to be rectified are sufficient to justify radical change, or whether sufficient improvements are capable of being made within the present framework. The case for a change rests to a considerable extent on Matthews' belief that a government department cannot provide the kind of management and staffing regime needed for a fully commercial operation.

30 ECGD, for its part, welcomes the emphasis in the Matthews Report on greater discretion in such areas as recruitment of staff and deployment of resources of manpower and machinery. All Departments support the proposals for greater clarity in financial objectives and responsibilities. The Central Departments, however, do not believe that Matthews itself or subsequent consideration by officials has yet demonstrated that the managerial advantages claimed from public corporation status would offset the costs identified in paragraphs 27-29 above: they believe that the precise managerial and related changes desired must be specified and evaluated before concluding that these could only be secured by a radical change in status and not within a continuing departmental structure.

31 Both ECGD and the other Departments have concluded, therefore, that these issues and the scope for changes within the existing Departmental structure, particularly in the context of the Financial Management Initiative and related developments, should be examined further. Partly in response to FMI, ECGD is already well advanced in developing and refining its business and financial objectives, and in piloting new technology. Closer scrutiny and control is being exercised over the financial outturn of individual facilities, and Ministers have agreed tighter guidelines for risk taking and subsidies in the more doubtful markets. If Ministers desired, these developments could be pressed further and faster.

32 The kind of changes that ECGD believe will be necessary to improve their efficiency and effectiveness and to impart the more businesslike approach regarded as desirable by Matthews lie mainly in its operational systems and in its ability to recruit, motivate and retain staff of the required background or experience in competition with analogous institutions.

33 They and the other Departments concerned therefore recommend that an immediate examination of ECGD's management system and operations should be undertaken by a Review Team led by ECGD at senior level, reporting to a Steering Group chaired by the Secretary. It might include businessmen of proven ability in fields relevant to ECGD's operations as well as representatives of the Central Departments and would be able to buy in, where necessary, advice on specialist topics eg information technology or management systems. The examination should begin in October, with a view to making specific recommendations to Ministers by the end of the year. The scope of such an examination might include, for example, the creation of a special grade of underwriters, the development of payments by results schemes, the infusion of commercial talent at appropriate levels into ECGD, and revised procedures for handling short term and project business. But these and other possible developments would be for consideration by the Review Team.

8 August 1984

APPENDIX A

RECOMMENDATIONS OF THE REPORT OF THE MATTHEWS COMMITTEE

The Matthews committee summarised the evidence they received as follows:-

1. The services ECGD provides are widely used and appreciated by the United Kingdom's exporting community, although there were criticisms;

2. The quality of credit insurance and financing facilities in general compared favourably with those available to competitors in other countries, although greater flexibility and cooperation with the private sector should be encouraged;

3. A number of factors associated with the Department's status and activities as a government department hinder its efficient operation;

4. There is a widespread feeling that some change in the way the Department operates is now desirable, provided that the change does not disrupt its on-going activities;

5. At present it is not practicable to devolve ECGD's activities to the private sector, in whole or in part.

Accordingly they recommended that:-

1. ECGD should be replaced by a government-owned corporation, suitably capitalised, which should retain close links to the centre of government. Its activities should embrace all those now being carried on by ECGD;

2. The corporation's guarantees should have, and be seen to have, the full backing of Her Majesty's Government;

3. The purposes of the corporation should be to provide insurance and financial services in support of exports, and to do so at a profit;

4. The corporation should have a board of directors, with statutory responsibilities, replacing the present Advisory Council arrangements;

5. The corporation should invest its reserves as determined by its board;

6. The corporation should be enabled to raise funds in its own right for on-lending in certain situations;

7. The corporation should be enabled to reinsure risks with Her Majesty's Government or with private sector insurers;

8. Its management should discriminate more between one risk and another than the Department now does;

9. The corporation should be paid for administering schemes on behalf of Her Majesty's Government which are outside its normal credit insurance or financing functions;

10. The new corporation would have greater freedom in its management and operations than ECGD believes it has at present. It should use this freedom, and the flexibility it will allow, to develop both cooperation and competition with the private sector insurance market;

11. A number of organisational and operational matters should be tackled by management once the question of status has been resolved.

APPENDIX B

INTERDEPARTMENTAL WORKING GROUPS

Four interdepartmental working groups, chaired by Treasury, Department of Trade and Industry, ECGD and Bank of England, considered in detail different aspects of the Matthews committee's conclusions. Papers on the following topics were submitted by these working groups to the main interdepartmental committee of officials:-

1. The Scope for Privatising ECGD Services - attached as appendix C;

2. Structural and Financial Implications - attached as Appendix D;

3. Trade and Competition Policy Issues - summary attached as appendix E I, full report at appendix E II, not attached;

4. Export Finance: Alternative Systems - summary attached as appendix F I, full report at appendix F II, not attached;

5. Staffing and Management Issues - report at appendix G, not attached;

6. Management of the ECGD Operation - report at appendix H, not attached;

7. The Export Credit Insurance Market - descriptive note at appendix J, not attached;

8. Comparison of the Major Official Credit Insurance Agencies - descriptive note at appendix K, not attached.

Copies of all appendices are available from ECGD, on request to 01-382/7427/7429.

SRC/AFC/1/8

MATTHEWS COMMITTEE FOLLOW-UP APPENDIX C

THE SCOPE FOR PRIVATISING ECGD SERVICES.

NOTE BY THE WORKING GROUP ON ECGD SERVICES

1 As part of their terms of reference, the Matthews Committee were asked to examine "the possibility of devolving any functions to the private sector or collaborating with the private sector in carrying them out". Their conclusion on this aspect of their investigation was to dismiss very briefly privatisation as an option for ECGD on the grounds that the private sector had neither the will nor the capacity to take on ECGD's insurance activities. This paper therefore examines some of the general background and attempts to analyse in considerably greater detail than appears in the report itself the possible scope for privatising the facilities presently offered by ECGD.

I BACKGROUND

ECGD's Activities

2 For the 65 years of its existence, the heart of ECGD's business has been insurance to exporters and bankers against bad debts. Losses can arise from 'commercial' causes (the buyer cannot pay) or 'political' causes (default by a Government buyer, or inability of a Government to pay foreign exchange). Traditionally such insurance, especially against political risks, has been too hot for the private insurers to handle, and the UK was one of the first countries to introduce a state scheme. The major exporting nations followed suit and, more recently, schemes have mushroomed in the third world, in many cases with technical advice from ECGD. All of them aim to break even.

3 From small beginnings, the scope of ECGD's cover has been progressively widened. Cover to exporters has been supplemented by unconditional guarantees to financing banks to ensure the availability of export finance at the best (in some cases subsidised) rates, and a range of ancillary facilities has been devised to support exports of major capital goods.

4 The scale of ECGD's business is now substantial. Some 30% of UK visible exports (other than oil) is covered and the total amount at risk under all current

guarantees exceeds £40 billion. Insurance is given either on a 'commercial' account, on the advice of an Advisory Council of businessmen and bankers, or on a 'national interest' account by agreement with Whitehall departments. Both accounts are subject to the financial objective to break even in the longer term on the insurance operations.

International Comparisons

5 As the separate papers on overseas credit insurers (OCIs) shows, there exists a certain fundamental similarity across the various institutions in that virtually all are government-backed and very few enjoy any real degree of independence in policy matters. Apart from the UK, only the Japanese operate entirely through a government department. Of the eight major OCIs no two are alike, varying from a private company operating as an agent of government (Hermes - Germany) to a state bank operating for its own account (Eximbank, USA). However most major OCIs, for example Hermes (Germany), Eximbank (USA) and EDC (Canada), are able to exercise a considerable amount of autonomy in day-to-day management matters.

6 On many more aspects, there exists a considerable degree of diversity. The UK, French and Japanese agencies all insure approximately one third of their national exports, but no other organisation operates on such a scale. The Italians come next with about 16% of exports, with the remainder covering less than 10%. Private sector insurance of exports is available in several other countries but nowhere does it underwrite any significant political risks on its own account and nowhere does it cover more than a tiny percentage of export trade (except possibly for the USA, the UK private market with 1-1½ per cent is probably the largest). The range of risks covered by the private sector is fragmented and varied but is probably larger in the UK than elsewhere. In addition, some overseas payment risks are carried by banks in all countries. Many exporters obviously self-insure, presumably because they perceive little risk in their own case.

7 Most export credit institutions have forged close links with the export financing mechanisms, in a variety of ways. ECGD guarantees repayment of funds mobilised by the private sector, at a guaranteed rate of return. In Germany, on the other hand, most export finance is provided by the banking system at strictly commercial rates of interest even for medium term credit which may sometimes be

supported by the assignment of Hermes credit insurance. In Japan the Export-Import Bank, (like the Eximbank in the USA on which it is modelled) mixes official funds with commercial money to support exports on medium to long credit terms.

8 The form and development of the various State-backed bodies obviously has been influenced by the environment in which they are required to operate, and the policy needs of the countries concerned, as perceived by the Government of the day. In sum, there is no obvious, ideal model against which to assess the best export support system for the UK, although OCI experience can be a guide in suggesting the range of alternatives.

II PRIVATISATION

Definitions

9 In discussing the subject of privatisation, it would be useful to define the term in the context of export credit support. In its conventional sense, privatisation is understood to mean the transfer to the private sector, via a stock market flotation or other form of sale, of a controlling interest in the existing assets and liabilities as well as the functions of a publicly-owned organisation. For the purposes of this paper, the privatisation of ECGD services is taken to encompass only the functions: that is, it refers to government disengaging from all (or an identified portion) of the services ECGD now provides, leaving them to be taken up - or not - by the private sector. It is assumed that the existing liabilities of ECGD would remain to be administered by the Department or Corporation until they were discharged; any "selling off" of these would, in practice, amount only to reinsurance, since the guarantees themselves could not be unilaterally transferred.

The Options

10 At present, ECGD is a Government department providing export services in the UK over which it now has a virtual monopoly. There is a small private market in export credit insurance but, although it has always been free to compete with ECGD, and probably could have done so in some areas such as short term business, as the evidence the Matthews Committee received from a variety of sources showed, it has serious limitations both as to capacity and breadth of cover. (See

separate paper). Many users of ECGD services have expressed their concern that if the Department's most successful activities were allowed to be picked off and privatised this would unbalance the remaining portfolio, leading to a vicious circle of falling business and rising premiums. Private sector insurers themselves told Matthews they could not foresee their replacing ECGD, particularly for exports on longer credit or to markets where "political" risks are significant, and because of the sheer scale of the business.

11 Despite the evidence to Matthews, privatisation at some stage is an intriguing possibility. We are constantly told that London is one of the world's most developed and sophisticated insurance and financial centres. The banks claim to have increased their medium term overseas lending at their own risk. The insurance market is heavily involved in domestic credit insurance, and the range of export credit insurance available in the private market is growing, though it is still small. The fact that ECGD has covered a steady one-third of UK visible exports for a number of years and has managed so far to operate on a break even basis suggests that there might be scope for significant privatisation in the longer term if others were to offer a wide enough range of facilities. However the scale of recent political claims and growing concern about sovereign risks casts doubt on this presumption. This raises two questions: what is the private sector capable of offering now, and how might greater private sector participation best be encouraged?

12 As the accompanying paper shows, the existing private sector's current activities are tiny compared with ECGD's; they are more specialist and discriminating in their availability and are best regarded as complementary to, rather than competitive with, ECGD's facilities. Even Trade Indemnity (TI), the most important and longest established of ECGD's "competitors", especially in the short-term field, have never expressed a wish to be widely competitive with the Department. Instead, they seem to want assistance in winning ECGD's best short-term business by the Department actually ceasing to provide cover for some transactions in the EC and USA. Such selection would affect premium rates for the rest of ECGD's business adversely (but see para 18).

13 In spite of the difficulties, three options for privatisation might usefully be examined. These are:

i) The closure of ECGD;

ii) The transfer of ECGD en bloc to the private sector;

iii) Partial privatisation of particular functions to assist the development of the private sector.

The Closure of ECGD or its transfer en bloc to the Private Sector.

14 Since the arguments relating to these two options are very similar, they are considered together. The only real difference would be an organisational one: option (i) would be likely to lead to the rapid fragmentation of export credit support as different organisations took up elements of ECGD's past activities whereas option (ii) would involve the transfer of the existing Department as a complete unit into the private sector. Effectively however, the success of either route would depend on whether the city institutions could be stimulated to meet the level of demand for cover if HMG withdrew from export credit insurance completely.

15 Certainly, the challenge would be formidable and Matthews, reinforced by the views of the private sector insurers themselves, was clearly sceptical about their ability to rise to it, even in the longer term. Given the major differences of scale and approach mentioned above, this scepticism is well founded. The capital that would be needed to provide a service similar to ECGD's would be vast and even if it could be found, its providers would expect a rate or return significantly greater than could be made compatible with an efficient, consistent and economical service to exporters.

16 Overall, either option would seem likely to lead to a significant cut-back in marginally profitable services with consequent problems for exporters who would find the availability of support fragmented, if in existence at all. Moreover, the cost of those facilities remaining available would probably rise considerably. This would price many exporters out of the credit insurance market completely and impair the competitiveness of those who remained able and willing to pay for cover. Those exporters transacting business on short credit terms and in the less

risky markets could probably obtain insurance or create an adequate internal reserve for bad debts. The banks would also no doubt finance those exporters who were themselves judged creditworthy. But there must be serious doubt about the position of many companies selling on longer terms or to riskier markets. This would inevitably lead to some worthwhile exports being lost and it could a cut a swathe through those capital goods industries which depend heavily on ECGD guarantees to encourage the banks to make available medium and long term export finance equivalent to that provided by major competitors' countries. The banks themselves have questioned the security that could be obtained from a private sector insurance guarantee from a number of aspects (see Private Sector paper). Withdrawal of ECGD support would also hit all those companies, not least the smaller ones, trading with the third world and for whom the Department's support is crucial.

Partial Privatisation

17 In practice, and for the reasons mentioned above, this is likely to mean initially giving the private sector access to some of ECGD's best business by means of the Department simply withdrawing from it. This might be considered a useful way of encouraging the private sector to start increasing the volume of its present activities and to gradually increase its capacity and range of facilities, both currently very restricted, eg by combining commercial and political risk cover. In theory this gradual approach might avoid, or at least minimise, the substantial dislocation to trade likely with either of the first two possibilities and help to identify clearly those areas of export support where government involvement is not essential. Although, even in the longer term, the private sector would be interested probably only in the most attractive few percent of ECGD's business and not any one facility as a whole, this might have the benefit of injecting an element of competition into those facilities at the margin offered both by the Department and in the market.

18 However, there are several aspects of the financial impact of this course on those activities remaining with ECGD which need further examination. As the private sector were allowed to take away ECGD's best business, premium increases would be needed progressively on the remainder to compensate for the reducing spread of business. From a national interest standpoint, it could be argued that

the economically sensible route would be to let the private sector assume what it can even if this does have the consequence of raising rates all round for remaining ECGD policyholders who might then be paying premiums more closely related to the risks insured. The reducing spread of business would also reduce scope for cross-subsidisation; in some ways this too would be defensible if it reduced the subsidisation of business in risky markets by that in safer ones. But against this, it must be remembered that a balanced portfolio is essential to all insurance operations. To unbalance it unduly in an arbitrary way would be to strike at a fundamental principle of insurance and when premium rates rose as a result, or if they became wider spread, there would also be a conflict with the trade policy objective of maintaining the competitiveness of UK exporters across the whole range of markets. Further, if ECGD's rates were wider spread it would be more difficult for the private sector to cream off the better business in straight competition and the sheer size of ECGD's portfolio would give it an advantage.

An Alternative Approach

19 An alternative to this approach might be to seek to encourage the private sector gradually to expand the scope of its activities so that it became more involved in supporting the whole range of UK exports rather than pursuing on a selective basis the minimal-risk business. This would have to be done initially through ECGD sharing in the risks new to the private sector, for an initial period at least. One method of doing this would be offer coinsurance opportunities to the private sector; another obvious mechanism would be to provide them with reinsurance facilities or to reinsure some risks with them. This latter collaborative technique is an essential and widespread ingredient of the insurance market, for smaller risks as well as large ones, and arguably offers a better long term prospect of increasing capacity and developing particular areas of business than competition alone.

20 To progress this, discussions between ECGD, representatives of the private insurers and perhaps also the DTI would have to take place. There would be various technical difficulties to overcome, but they should not be insurmountable given goodwill on both sides. However, the process would be slow and for it even to begin in those areas it would have to embrace to be worthwhile - notably political or longer term risks - there would have to be a sea-change in the private

sector's attitude to the UK's overall needs. Another difficulty that could arise concerns overall costs to exporters. If ECGD offered reinsurance facilities to the private market, charges could rise, at least in the short term. Also ECGD's total exposure might increase.

Conclusions

21 In summary, although it may be possible to encourage the private sector to develop and expand to the extent that it might be able to compete with at least some ECGD services to an extent significant in national terms, this seems some way off. There therefore seems no reason to question the Matthews Committee's conclusion that there is not, for the present at least, much scope for privatisation. The private sector could not provide a competitive insurance service for UK exports if ECGD facilities were rapidly withdrawn. Even so, despite much evidence which points to the limited development and capacity of the existing private market, and the need for a strong government role in export support, the private sector may have a useful contribution to make and greater collaboration with them through reinsurance could be the first step towards partial privatisation. To this end, discussion should begin with representatives of the private sector insurers. Although any major replacement of ECGD's facilities by the private sector seems to be a long way off,two-way benefits may begin to flow from closer collaboration, but while the governments of our main trading competitors continue to involve themselves so deeply in support for exports a cautious step by step approach will be appropriate.

M/17/7/84/2

APPENDIX D

MATTHEWS COMMITTEE FOLLOW-UP

STRUCTURAL AND FINANCIAL IMPLICATIONS

NOTE BY THE WORKING GROUP ON STRUCTURE AND FINANCE

1. This note examines the structural and financial implications of the recommendations in the Matthews report. It does not seek to consider alternatives such as privatisation or improvements within a departmental status, which are to be covered elsewhere. The principal areas covered in this note are:-

(i) The division of business between the proposed Export Credit Guarantee Corporation ("ECGC") and the Government (paras 3-11)

(ii) the treatment of business underwritten for the Government's account (paras 12-18)

(iii) the treatment of public expenditure programmes (paras 19-20)

(iv) the structure, financial organisation and staffing implications of ECGC (paras 21-42)

2. The critical decisions in setting up a new Corporation will be the definition of the functions that it performs on its own account and those performed on behalf of the Government, the split between these and their financial and administrative treatment. These areas are therefore covered before questions relating to the detailed structure and organisation of the Corporation.

DIVISION OF BUSINESS BETWEEN ECGC AND THE GOVERNMENT

3. Because of limitations imposed either by its capital structure or by the more stringent financial remit to which it would be working, ECGC would be unable to take on its own "book" the full range of risks currently handled by ECGD. It is, however, assumed that Ministers would still wish, in the national interest, to continue to support certain risks considered uninsurable by ECGC. The Matthews report suggests that the Corporation could enter into reinsurance arrangements with either private sector insurers (where the risks were commercially insurable and where the Corporation was constrained for capital or

portfolio reasons) and with the Government (where the constraint was the uncommercial nature of the risk). The need for, and extent of, insurance with the private sector would be a business decision to be taken by the board of [illegible] to be weighed against other options, such as requesting an increase in the Corporation's capital.

4. The arrangements for dividing the risks between ECGC and the Government would need to be specified from the outset. The definitions of political and buyer risk used, and the distinction between them, will be critical, and will need to be clearly established so that each cause of loss is clearly attributable to either the Corporation or the Government. Matthews proposes that the arrangements between ECGC and the Government should take the form of Treaty Reinsurance, the term used in the insurance market for an arrangement under which certain pre-determined risks are automatically passed back by the primary insurer to the reinsurer. Whatever the term used, a permanent framework for handling these risks would be essential since it would be impractical for ECGC to pass back to the Government, on an ad hoc basis, each case with risks which it regarded as commercially uninsurable. Defining in advance the precise areas of risk to be covered by ECGC and the Government poses considerable difficulty, and there are a number of possible approaches to this division of risk. Four of these are analysed below.

5. Option 1. ECGC would take on all risk that it considered commercial. In practice, this would probably mean that all buyer risk (except perhaps very large one-off risks which might unbalance its portfolio) would be for ECGC's account. The Government would therefore only assume buyer risks for cases which were exceptional due to their size or non-commercial cases where it was decided to support the risk despite security viewed by ECGC as inadequate. Some political risks, such as those on 'D' markets would clearly be for the Government's account; others are not so clearly or easily attributed to either account, and their distribution would require specific negotiation between the Corporation and the Government. This might result in the risk on individual markets within the same grade being allocated to different accounts and/or the amount of overall exposure on individual markets being shared between the two accounts (with ECGC taking political risk up to a predetermined amount and the Government the balance). The perception of the nature of risk on individual markets will change over time, and, under this option, there would therefore need to be a fluid arrangement between the Government and ECGC so that the

distribution of risks, for new business, between the two accounts is changed either in accordance with ECGD's view of what, at any time, represents a commercial risk, or as the result of agreement between ECGC and the Government.

6. This option would leave ECGC free to take on the widest possible range of risks, and thus the maximum amount of business, that it considerable desirable (constrained only by its capital structure and the need to meet its financial objective). The maximum use of the Corporation's resources and expertise would tend to reduce the need for duplication of effort by the Government. However, any division of risk between the Corporation and the Government will produce problems at the borderline, and a fluid borderline will accentuate this. Such a division of risk will also, as with the other options below, produce a split of responsibility for export credit policy.

7. Option 2 This would be an arrangement similar to that of COFACE in France, under which ECGC would underwrite buyer risks only. This might be expanded to cover a very limited and clearly defined level of political risk (such as for short term business in A and B grade markets only).

8. This option has a number of advantages. Under this, the risks to be covered by the Corporation or by the Government would be distinct and unchanging over time. This would make for much clear public accountability and would make ultimate privatisation much easier. The Corporation would tend to specialise in the analysis of buyer risk, and the Government would tend to provide most of the country risk analysis although there would still be some duplication of effort. The risks covered by the Corporation would be unquestionably commercial; the achievement of its financial objective should therefore be much more within its control than if a range of less predictable political risks were to be underwritten. The main disadvantage would stem from the need to establish within Government a sizeable establishment charged with the operation of the political risk account. It would also limit the effect of any benefits from public corporation status (although the agency arrangements discussed below could also apply).

9. Option 3 A split of risks between the Corporation and the Government on the lines of the present Section 1/Section 2 split. This would reflect the commerical/national interest split of the existing arrangements, even if, in practice, this might not be very different from Option 1. However, the existing

system normally covers an individual case on one account, and this would minimise the inevitable complications where risks on a single policy were allocated between the two accounts.

10. Option 4 The Corporation would assume all the present ECGD risk portfolio except those risks which are obviously inconsistent with its financial objective or capital structure. This would reflect the break-even objective of all ECGD's existing insurance business, and would allow the maximum scope for the effect of benefits from public corporation status. Under this option, the presumption would be the opposite of that in Option 1, so that all business accepted for the Government's account would need to be specifically justified, rather than the Government automatically accepting the balance of risk. This would clearly have an impact on the capaitalisation and financial objective of ECGC, but there is no obvious logic in the Government setting up a Corporation with a capital base and/or explicit Government backing, and then retaining the bulk of the business itself.

11. All of these alternatives involve some split of business, and hence of responsibility, between the Corporation and the Government. This is likely to lead to some additional cost (which must be met by the exporter or the taxpayer). Clear arrangements will be needed to define the relative responsibilities of the two parties. The perceived benefits, for each alternative, of public corporation status, will therefore need careful consideration.

THE TREATMENT OF BUSINESS UNDERWRITTEN FOR THE GOVERNMENT'S ACCOUNT

12. Under all the alternatives covered above, a range of risks would remain to be covered by the Government. From a practical viewpoint, it would be sensible for the Corporation, in respect of those guarantees partially or fully undertaken by Government, to perform not only the administrative functions - issuing the policy, collecting premium, maintaining records, processing and paying claims - but also to have an underwriting authority within delegated powers granted to it by the Government. The arrangements could therefore provide for:-

(i) a reinsurance agreement to be entered into between the Corporation and the Government defining the precise risks to be carried on each account. This would be subject to periodic review and would provide for case by case treatment of exceptional cases (eg inordinately large buyer or political risks);

(ii) the Corporation to be given delegated authority from the Government to underwrite Government account business within predetermined limits;

(iii) the Corporation to process all applications for cover falling within the delegated authority and to issue a single guarantee in its own name covering the full range of risks;

(iv) the Corporation to notify Government of risks so underwritten and to pass back to the Government the premium collected by it relating to the Government account risks[1];

(v) the Corporation to process all claims and to be authorised to admit liability where applicable, on behalf of the Government account and to meet such liability out of funds granted to it by HMG[1].

The main feature of these arrangements is that the Corporation would effectively act as the Government's agent, recovering its costs directly or indirectly from the exporter.

13. The level of premium charged for risks insured for the Government Account would, however, need to be determined by the Government. Premium rates would continue to be set at a sufficient level to cover costs, ie underwriting losses, cash-flow costs and administration expenses. To arrive at appropriate premium levels for each class of risk a premium review process, such as that currently conducted by ECGD, would need to be operated by the department responsible for the Government account. Initially, rates would probably have to be those presently charged by ECGD for the same business or, where the risks are split between the Corporation and Government, an agreed part of it. Fine tuning of the rates will only be possible in the light of actual experience of the trading performance of the Government account.

14. Accounting The financial management of the Government account would be the responsibility of the department on whose behalf the Corporation issued guarantees. Since DTI seems to be the obvious sponsor department for ECGC, it would be logical for the Secretary of State for Trade and Industry to continue to exercise the powers to give guarantees in the current Export Guarantees Act, subject, as before, to the consent of the Treasury, and therefore for the DTI Accounting Officer to be responsible for the Vote covering both the administrative costs, premium and claims payments on the account together with

---

1 The attribution of premium income and claims payments to the two accounts would depend on the designation of the risks at the time when the cover was underwritten.

any trading fund account (see below) and for the department's judgement of risk on the business taken onto the account as well as for the propriety of payments and the efficiency of its organisation, including the agency arrangement with the Corporation. The PAC could be expected to enquire into these aspects. In addition, but probably of less significance in resource terms for the department, would be the exercise of sponsorship functions in relation to ECGC including negotiation of the Corporation's external financing requirement, accounting for funds advanced to, or received from, ECGC (eg NLF loans), scrutiny of corporate plans, etc.

15. A more complex issue is whether the "programme" should be classified as public expenditure or as a trading activity. International considerations - the need to show transparently that the scheme meets the GATT prescription that the premium charged is sufficient to cover costs and that the scheme is not operated as a subsidy - might suggest that it should be operated as a trading activity against a break-even financial objective requiring the production of annual Trading Accounts subject to audit by the National Audit Office. This might, however, ignore the nature of the risks covered by the Government account. In terms of the balance of the portfolio, these would be <u>all</u> the political risks and those buyer risks which could not be accommodated by the Corporation. Though ECGD's experience suggests that, except in certain narrowly defined circumstances, substantial loss is not suffered due to the occurrence of political risks, this may well not hold good for the future. The unpredictable nature of the risk and the long periods of exposure suggest that the account might be more appropriately operated as a public expenditure programme. This view would be reinforced if the Government account would carry only those worst political risks which the Corporation was unwilling to take on its own account.

16. <u>Departmental Responsibility for Risks</u> The Matthews report suggests that departments sponsoring individual non-commercial cases should bear any eventual costs of this business on their own Votes. A particular example of this would be 'sharp' arms business, which is not covered by most of the international agreements covering the terms of export credit, and which ECGC is unlikely to see as commercially insurable. The Group takes the view that, while it would be desirable to implement the report's recommendation, this does not seem practicable. Effective attribution of responsibility would mean bringing this within the Public Expenditure Survey (PES) arrangements, but the liabilities underwritten will normally stretch well beyond the PES horizon. It is also often

difficult to identify a single department to bear responsibility, since several interests will be involved. In the example of arms sales, industrial as well as defence arguments are important.

17. Interdepartmental arrangements Even if DTI assumes the accounting responsibility for all Government account business, there will still be a need for the interdepartmental machinery provided by the Export Guarantees Committee (EGC). This would continue to consider country limits, decisions to withdraw and restore cover, and individual exceptional cases (with reference to Ministers where agreement is not reached). It would provide a forum in which ECGC's technical and administrative expertise could be brought to bear on issues of export credit policy on which Government departments will be taking the principal role in both domestic and international discussions, and would also allow other interested departments, principally MOD, FCO and ODA, but on occasions also DOE, DEn and DTp, to put forward their views. MOD and FCO are particularly anxious that such a forum should continue to exist. EGC might also play a role in discussing and agreeing with the Corporation any changes in the division of risks.

18. The agency arrangements envisaged above would mean that there was little difference from the existing system for the exporter, since one organisation would continue to administer all insurance activities. There would only be a positive benefit if the arrangements are more efficient or cheaper. The report expects increased efficiency due to public corporation status, but agency arrangements will mean that, unless ECGC is given a degree of freedom that raises questions of accountability and the interests of the taxpayer, its operation of the Government account will inevitably be less direct and immediate than for business for which it is fully responsible. Unless there are significant savings from greater efficiency, there is a danger that the net costs of a split administration of export credit insurance, part of it with a profit objective, might be greater. Either the exporter or the taxpayer will have to bear such costs.

THE TREATMENT OF PUBLIC EXPENDITURE PROGRAMMES

19. Agency Arrangements There are three areas in which ECGC might act as agent for the Government: for reinsured Government account business (discussed

above), for the administration of ECGD's existing subsidy programmes, notably interest support, and for any additional publicly funded advisory or non-insurance services. The report attaches particular importance to the recommendation that the Corporation should retain all ECGD's existing functions, so as to continue to provide 'one stop shopping' for exporters. While such agency arrangements are quite feasible, and would reduce duplication of administration, this does raise important questions of financial control and the extent of delegated authority, given that the sponsor department would retain accounting responsibility. Adequate arrangements for monitoring value for money in these agency operations would be needed.

20. While exporters might naturally prefer to deal with a single agency for credit insurance, export finance and advisory services (and there are clearly close links between them), this is not the general pattern overseas. There is also an inherent conflict of interest between the maximisation of credit insurance business for ECGC's own account and the minimisation of the interest subsidy which it would administer on behalf of the Government, since the access to subsidy would be an important attraction of ECGC's insurance policies. This raises the question of whether the existing link between ECGD credit insurance and access to interest subsidy should be maintained. The question of agency fees raises the problem of additional public expenditure: at present all ECGD's administrative costs are met from premium income, and while the cost of administering the Government account insurance would presumably be met from the premiums charged, this leaves the cost of administering the public expenditure programmes and any advisory services. It might be thought that it was appropriate for exporters to bear these costs.

THE STRUCTURE AND FINANCIAL ORGANISATION OF ECGC

21. The Matthews report recommends that ECGD should become a public corporation. These are defined, for national accounts purposes, as corporate bodies owned and controlled by Government on a basis that is intended to be permanent. Government control is over broad aspects of policy (mainly in relation to capital investment and borrowing, prices, assets and liabilities), and public corporations typically enjoy a wide measure of day to day management autonomy. Nationalised industries are public corporations primarily engaged in industrial or other trading activities, usually deriving the bulk of their income directly from their customers. Their boards are appointed by Ministers, and they

are subject to a broadly consistent set of financial disciplines and controls. Prima facie, the profit making corporation envisaged in the report should be treated for most purposes as a nationalised industry.

22. **Statutory basis** In line with recent practice for nationalised industries, legislation would define the purposes of ECGC in broad and general terms, and would provide for Ministerial supervision through a suitable combination of general and specific direction powers and consent or approval requirements. The statute would set out the form of Government backing for ECGC's liabilities, and establish borrowing limits and maximum contingent liabilities (such as now apply to ECGD). It would also give the power to set financial targets. New legislation or substantial amendment to ECGD's current Act would also be required to provide for the Government account business, and should similarly restate the purposes of such business.

23. **Sponsoring Department** DTI would be the logical sponsor for a credit insurance corporation. If, however, ECGC assumed a significant direct export financing role, this might need to be reconsidered. The interests of other departments with an interest in export credit policy would be covered through the interdepartmental machinery discussed above.

24. **Structure and Composition of the Board** Current practice is to have a Board of no more than 12 members, the majority non-executive. Although the selection of suitably experienced or expert members is generally left to the sponsoring Minister's discretion, specific provision might be made in the legislation. The report recommends that senior officials from DTI and the Treasury should be on the Board: the representation of serving civil servants on public corporation boards is contrary to current practice, and may pose problems of conflict of interest, but might have countervailing advantages in this case because of the very different nature of ECGC. Non-executive members of the Board would not represent specific interests, although a range of relevant experience would no doubt be sought. It would seem appropriate, and consistent with precedent, for Board members to be disqualified from membership of the House of Commons and the European Parliament.

25. **Financial Structure** The financial structure of ECGC will be critically dependent on its functions, and the volume and type of business currently undertaken by ECGD that it assumes. Before these issues are finally

decided, all that can be suggested are guidelines for a possible financial structure.

26. The Matthews Committee recommended that the Government should stand behind the Corporation. Business reinsured with the Government would carry an explicit guarantee. There is however a problem over the extent of the Government liability for the Corporation's own account business. The Government would be the ultimate owner,and it is inconceivable that the Corporation would be unable to honour its obligations on this business. However the banks and exporters will, we believe, look for a more explicit guarantee. It will be necessary to decide whether to provide for this explicitly in the legislation, or to put the Government's intentions on record in Parliament during the passage of the Bill. It is for consideration whether the Government should charge a fee (to be passed on to the exporter in his premium) for the additional security provided by such a watertight guarantee. There is also a link between the strength of this guarantee and the size of the capital base required. The stronger it is, the less will the Corporation be subject to the financial disciplines stemming from a fixed capital base.

27. Government backing for the ECGC's borrowings and for its credit insurance guarantees could be given in a number of forms: by statutory direct access to the Consolidated Fund, in the last resort (as is now the case for ECGD's insurance guarantees), by a direct Treasury guarantee, by the implicit undertaking enjoyed by existing nationalised industries, or, as is the case for the Canadian Export Development Corporation, a public undertaking to put the Corporation in funds and to make up losses. If ECGC's guarantee is not directly guaranteed by the Government, there is a problem of two different perceptions of quality. But if ECGC can commit the Government explicitly, financial controls will be tighter than for a corporation with only an implicit undertaking. As mentioned above, it is also assumed that there would be statutory borrowing limits and, as now, maximum contingent liabilities. There would need to be separate limits for "own account" and "Government account"/reinsured business. Since the legislation would also give the power to set financial targets, a financial control and monitoring system, on the lines of those for existing nationalised industries would also be set up; this is discussed in more detail below.

28. Treatment of ECGD's existing business There is some agreement within the Group that the best approach would be for ECGC to maintain separate "ECGD" accounts (in the existing form) for all business underwritten before vesting day and would administer this business as agent for the Government. These accounts would be kept until all risks had run off: the distribution of any accumulated reserves between the Corporation and the Government would then be for consideration. Although this approach has obvious attractions, it does raise questions of responsibility and monitoring which will need to be considered further. Alternatives would be for ECGC or Government to take direct responsibility for the existing business, or for each to take part of it, perhaps on the basis of a Section 1:Section 2 split.

29. Capitalisation The report recommends that the Corporation should be capitalised "adequately for its likely needs". It suggests that this will allow greater freedom of action and would encourage a more commercial approach. It is not clear exactly which risks a capital base would be meant to cover if direct Government backing is retained. For the purposes of this note, it is assumed that ECGC would have no direct export financing role: if it did, this might have a major impact on the size of capitalisation required.

30. There are a number of possible approaches to the calculation of a suitable capital base. The size will depend on whether ECGC starts from new or takes over some or all of ECGD's existing business, and on whether the direct backing of Government is intended to cover any unusual cash needs (such as the present debt crisis) or only to operate in the last resort. In the former case, the capital required will effectively be working capital, and may be relatively limited, depending on the size of the Corporation's balance sheet and contingent liabilities; if however, the Corporation is intended to stand alone for all normal operations, it would need a significant equity cushion, which would have corresponding PSBR and PES implications. Pension funding liabilities might also be an important factor in determining the size of the capital base.

31. The size of the capital base will also be affected by the type of prudential supervision envisaged. The only external requirements which might apply to ECGC are the EC solvency margins and these do not seem to be serious constraints. However it is understood that commercial insurers treat these very much as a minimum, and typically seek to increase them by a 100 percent loading. There are no obvious parallels among major credit insurers with which to compare

a directly Government owned Export Credit Corporation. Two possible comparisons are the US Eximbank and Canadian EDC, both wholly Government-owned, but also involved in direct borrowing and lending. EDC, but not Eximbank, has explicit Government undertakings that it will be kept in funds. Annex A compares their capital and liabilities with those of ECGD, and indicates that, to match them, a very substantial capital injection would be required. This would be required immediately if ECGC takes over existing business, but otherwise in line with the development of its business.

32. The composition of the Corporation's capital base would depend on its size and function. It would be normal for this to take the form of a fixed amount of Commencing Capital Debt to the Exchequer: this could consist of interest bearing NLF loans, Public Dividend Capital (PDC) or possibly some form of preference capital. If what is required is essentially working capital, NLF loans would be appropriate: if equity is required, PDC or preference capital would be needed. A large part of such equity capital might be uncalled (as is the case for the World Bank), which would reduce the public expenditure impact without affecting the extent of the Government's commitment. Any initial capital would score as public expenditure in the year of vesting, and any subsequent payment of uncalled capital would score in the relevant year. In any event, the Corporation's capital would not be costless, and the payment of dividends or interest would be required by statute. The scope for possible future privatisation will also affect the structure chosen for the capital base.

33. <u>Financial Control</u> In addition to any statutory limits on liabilities, there would be a detailed system of financial control by the sponsor department. For existing nationalised industries, this is based on financial targets (principally an agreed target Return on Capital Employed) and an External Financing Limit. There is also discussion on, and approval of, each industry's corporate plan. This system would need to be adjusted to the particular circumstances of an Export Credit Corporation: since there would be few fixed assets, ROCE would not be a suitable indicator, and although an EFL might be difficult to enforce, because of the likely volatility of the Corporation's cash requirements, it would formalise existing work on cash planning and setting cash targets for ECGD. But the report recommends that the Corporation should operate at a profit, and there would be an agreed target for this (perhaps expressed as an actual or percentage increase in reserves). There would also be an agreed corporate plan, covering areas such as country limits as well as purely financial

aspects. Arrangements for any "agency fees" for services performed on behalf of Government would also need to be agreed and formalised. The general impression given by the report that the Corporation would have untramelled freedom of action, yet enjoy the full backing of Government, would be incompatible with the established policy on the control of public corporations. The degree of financial control, and limitations on freedom of action, that would be required to be consistent and to protect the Exchequer would reduce the perceived attractions of public corporation status.

34. Accountability to Ministers and Parliament Arrangements for accountability to Parliament should broadly follow those for the nationalised industries. In general the sponsoring Minister (or Ministers) would answer to Parliament for broad policy aspects but not for day to day management. "Policy aspects" would include in particular justifying the use (or non-use) of any statutory directing powers: and questions concerning performance in relation to agreed financial objectives. The following statutory accountability requirements would probably be needed:

- an annual report to be submitted to the Secretary of State and laid by him before Parliament;

- an obligation to render accounts in a form meeting the requirements of the SOS and consented to by the Treasury. (The British Telecommunications Act 1981 refers to "information to be contained in the statement of accounts; the manner of presentation; and the methods and principles according to which the statement is prepared").

- accounts to be audited by external auditors (either approved by the SOS, or appointed by him in consultation with the corporation). Audited accounts to be sent by a specified date to the SOS, who lays them before Parliament.

The Government is currently considering legislative proposals which will contain comprehensive provisions replacing existing legislation on nationalised industry reports; accounts; audit; appointment, compensation and dismissal of board members; borrowing limits and powers; clawback of surplus funds; reserves; break-even duty and financial objectives; and the creation and disposal of subsidiaries, properties and rights. This will provide a pattern which might be applied to the new Corporation in whole or in part when it is established.

35. Existing public corporations are expressly excluded from the list of Crown-appointed bodies to which the National Audit Office have access. The

National Audit Act (S.7) also excludes bodies which in the relevant year received less than 50 per cent of funds from Government. The establishment of an export credit corporation, which might still be benefitting from explicit Government backing, would therefore remove a significant area of Government expenditure from Parliamentary financial scrutiny. This would not only be controversial in itself, but might well reawaken earlier arguments in favour of extending NAO's scope to cover nationalised industries generally. The NAO will certainly expect to have access to papers relating to Government account business, and is also likely to examine the sponsoring department's monitoring of ECGC's commercial risk.

36. Existing public corporations do not exercise their functions on behalf of the Crown, and are therefore outside the scope of the PCA Act 1957. The PCA does, however, have access where, exceptionally, a non-Crown body performs functions as an agent for a Government department. It is thus possible that ECGC might be open to scrutiny in respect of its agency functions. Whether an export credit coporation would be subject to select committee scrutiny would depend on whether the sponsor department and the relevant Committee agreed that it was an "associated body" of the department for the purpose of the relevant House of Commons standing order. The test - as stated by the Chancellor of the Duchy of Lancaster, on 25.6.79 - is "whether there is a significant degree of Ministerial responsibility for the body concerned". This has been interpreted as extending in principle to nationalised industries, although select committees have largely confined their interest to the broader policy matters on which Ministers would normally answer to Parliament. The Trade and Industry Committee would presumably be the relevant committee if DTI is to be the sponsor department. ECGC might also be eligible for efficiency studies under the Competition Act 1980.

37. **Privatisation** The report sees little scope for the privatisation f ECGD's business, and this reflects a widely held view. Nevertheless the case for this is being re-examined by the ECGD-led Working Group. The scope for immediate or eventual privatisation of all or part of the Corporation's business is likely to influence significantly Ministers' reaction to the recommendation for public corporation status. In the context of this paper it is therefore necessary to consider whether any particular risk portfolio or capital structure is likely to be helpful in the realisation of such an objective. The risk portfolio which would lend itself best to eventual privatisation would be one where the incidence of loss, the volume of business and the running costs could be predicted with

reasonable accuracy. A pure buyer risk portfolio would best meet this prescription, but even here the relationship between the political and buyer risks in the developing countries may mean that a truly commercial, privatisable portfolio, would perhaps be restricted to the buyer risk in only the more developed countries. For eventual privatisation, the most suitable risk portfolio for the Corporation might be the more limited one described in paragraph 7 (option 2). Alternatively to ease privatisation but to adopt the recommended wider risk portfolio for the Corporation, the truly commercial "kernel" of the Corporation's wider risk portfolio might be underwritten by a separate subsidiary. This would, however, make for a very fragmented and probably unacceptable provision of credit insurance support in any post privatisation scenario - a Government scheme, a private sector scheme and the residual public corporation scheme.

38. If privatisation was seen as a possibility in the short term, the "privatisable" business could be established as a Companies Act Company whose equity was wholly owned by Government. This would then facilitate subsequent privatisation. Companies Act status would not, however, be a satisfactory alternative to public corporation status if privatisation were to be regarded as a longer term objective. If the public corporation were eventually to be privatised, special arrangements would need to be made at the time to achieve this: the structure of the initial capital as between equity and loans, and the form of each, does not therefore need to take account of the prospect of privatisation.

39. Borrowing powers The report suggests that ECGC should be able to finance its cash requirements from either the public or private sector, in addition to any borrowing to fund export finance loans. The Working Group on export finance will recommend that the export financing role for ECGC is one of the options to be considered in a wider review of the arrangements for providing export finance, so that this note will only cover borrowing by ECGC for its own account. Existing nationalised industries have only very limited powers to borrow outside the public sector, and any divergence from this would need to be justified, and could have implications for other nationalised industries. As the Government is the ultimate guarantor, there can be no statutory limit on the Corporation's right to borrow from the Consolidated Fund (or, in the extreme case, to draw money without repayment) in order to meet its obligation. The effective Parliamentary control over such recourse will be by the statutory

control over the amount of business the Corporation may undertake (analogous to the present statutory limits on ECGD's risk). If recourse to the NLF is envisaged a separate borrowing limit would be needed. This will need to be supplemented by a range of administrative financial controls exercised by the Government as part of the corporate planning process, including controls over temporary borrowing and borrowing in foreign currencies.

40. **Freedom to invest reserves** The freedom to invest reserves within prudent guidelines is seen in the report as an important objective. Public sector organisations are expected to invest their reserves within the public sector, except for short term surpluses, which are treated as fluctuations in working capital. Any variation from this would have implications for the PSBR and would need a strong justification. The ECGC would expect, certainly in the early years, to have cash surpluses to invest and the question would need to be addressed as to whether it should have freedom to invest outside the public sector and whether it should conform to standards laid down for insurance companies in the private sector. If it should be so permitted, expert staff would need to be recruited or bought in.

41. **Foreign currency balances** There would be a clear commercial logic behind the Corporation being able to accept premia in foreign currencies, and to hold foreign currency balances to match, at least in part, its foreign currency liabilities. Since a Corporation would not be able to deposit foreign currency balances with the EEA, arrangements for deposits outside the public sector would need to be agreed. The use of hedging to reduce or eliminate interest and exchange rate exposures will also need to be looked at. This, too, would require skilled staff, either in-house or bought in.

42. **Staff** The report envisages that ECGC would take over all ECGD's existing staff, but would thereafter be fully responsible for its own employment and recruitment policy. The transitional arrangements would require careful planning, and detailed legal advice, but would need to ensure that employees taken over from ECGD enjoy terms and conditions (including pension arrangements) no less favourable than they enjoy in the Civil Service, unless agreed compensation is to be paid. Pension arrangements, which could have a material impact on the financial structure of the Corporation, would need particularly careful consideration. An aide-memoire on the issues involved in the transfer of staff from the Civil Service is at Annex B, which ECGD have seen. In view of the

importance attached in the report to the benefits of greater freedom of staffing, it will be necessary to work out the structure that such freedom would permit, and to confirm that this could not be achieved without a change of status.

ANNEX A

COMPARISON OF NET ASSETS AND LIABILITIES

	UK ECGD £ million			CANADA EDC C$ million		USA EXIMBANK $ million	
	31-3-82	31-3-83	(projected) 31-3-84	31-12-81	31-12-82	30-9-81	30-9-82
Capital	-	-	-	350	465	1000	1000
Reserves	668	863	938	185	186	2199	2040
Equity	668	863	938	535	651	3199	3040
Amounts at Risk							
Loans				3580	4445	15802	16565
Guarantees	25530	31768	32944	2189	1928	13457	12153
Total	25530	31768	32944	5769	6373	29259	28718
Equity ÷ AAR (%)	2.6	2.7	2.8	9.3	10.2	10.9	10.6
Amounts at Risk (Guarantees weighted 0.5)							
Loans				3580	4445	15802	16555
Guarantees	12765	15885	16427	1095	964	6729	6077
Total	12765	15885	16427	4675	5409	22531	22642
Equity ÷ Adjusted AAR(%)	5.2	5.4	5.7	11.4	12.0	14.2	13.4

Section 1	1982	1983	ECGD (£ million)	Section 2	1982	1983
Reserves	214	182			455	680
AAR	13264	14285			12266	17483
Equity ÷ AAR (%)	1.6	1.3			3.7	3.9
Equity ÷ Adjusted AAR	3.2	2.6			7.4	7.8

Additional Capital required for ECGD

(a) for Equity ÷ AAR ratio of 10% £2356 million

(b) for Equity ÷ Adjusted AAR ratio of 12% £1033 million

This assumes that existing assets are correctly valued. Any write down would directly increase the additional Capital required.

Additional capital required for Section 1 Account (based on 1983 results)

(a) for 10% Equity ÷ AAR ratio £1246 million

(b) for 12% Equity ÷ Adjusted AAR ratio £ 675 million

ANNEX B

Transfer of Staff

Certain transfers of staff from one employer to another are covered by the EC Acquired Rights Directive 1977 (77/187/EEC) which has no direct force in UK law, but is applied by the Transfer of Undertakings (Protection of Employment) Regulations (1981 No 1704). The Chief Secretary to the Treasury has, however, said that departments should not take any action which conflicts with the provisions of the Directive. Broadly speaking, the Regulations specify that the staff of an undertaking to which they apply are entitled to be transferred automatically when that undertaking is transferred to a new employer, with continuity of employment, and on the same terms and conditions of employment (apart from pensions). Staff may not be made redundant except for 'economic, technical or organisational' reasons connected with the transfer. It is important, therefore, that legal advice should be taken as to whether the Regulations apply to the proposed transfer and whether the Directive itself should be taken into account. All employees have rights to protection against unfair dismissal under the 1978 Employment Protection (Consolidation) Act.

If the Regulations apply and it is thought desirable to change the staff's terms and conditions of service on transfer, this must be done by agreement. One method is

for the new employer to make offers of jobs to the staff of the undertaking on terms which, taken as a whole, are no less favourable than those they enjoy in the Civil Service. It should be made clear to staff that acceptance of such offers would be construed as resignation from the civil service, so that the staff would not be eligible for treatment under the redundancy provisions of the PCSPS when they transfer. Such a course could be open to challege if it can be shown that staff are not fully aware of all their rights and entitlements at the time when they make their choice.

If in such a situation the terms and conditions of the new employment are to be less favourable as a package than civil service terms and conditions, it will be for consideration whether staff should be offered compensation for any detriment involved in order to persuade them to agree to the terms of the transfer and accept job offers. It may be desirable to take powers in legislation to make such payments. Although pension arrangements are not covered by the Regulations, the unilateral withdrawal or variation by an employer of pension rights could lead an employee to claim successfully that he had been constructively unfairly dismissed under the 1978 Employment Protection (Consolidation) Act. Compensation for detriment in relation to pension arrangements may therefore also have to be considered.

Legislation covering a proposed transfer can therefore either provide for automatic transfer of staff on identical terms and conditions under the Regulations (as in the Ordnance Factories and Military Service Bill, Schedule 2) or provide for the new employer to make job offers to the staff on terms which, taken as a whole, are no less favourable than existing terms and conditions of employment (as in the National Audit Act 1983, Schedule 2), although there must be some doubt whether this latter approach would be held by the courts to be fully consistent with the ARD. In either case, the legislation may also need to contain a provision that a member of staff who is transferred, or who accepts an offer of employment from the new employer, shall not be eligible to be treated under redundancy procedures or receive redundancy compensation from the PCSPS. Where the terms and conditions offered are equivalent such a provision may also be applied to staff who unreasonably refuse job offers, but whether this is desirable will vary from case to case and legal advice will be relevant.

Secondment

The use of secondments to aid the smooth transfer of staff to the new public corporation might appear to have some attractions, but these need to be weighed against a number of legal and practical difficulties which might arise if secondment is used in this context.

The general and widespread use of secondments, either initially to man the operation until incorporation or as a longer term means of staffing the corporation with a succession of secondees, does not appear to be appropriate in this case. The work can be continued by ECGD until

the new corporation is established. When it is established, there will no longer be a suitable department from which secondees could be sent and, more importantly, to which they might eventually return to be redeployed, as the ECGD would no longer exist.

The more limited use of secondment of particular staff to fill particular posts, e.g. to ensure continuity at the outset or as a means of broadening career development, may have a place, subject to three important considerations.

First, staff cannot be compelled to accept secondment against their wishes.

Secondly, the purpose of secondment, (as indicated in pragraph 10277-10279 of the Establisment Officers Guide) is primarily to further an officer's development within the context of a Civil Service career and to increase the efficiency of the service as a whole.

Thirdly, an officer should only be seconded where the exporting Department is confident that they will be able to redeploy him on return, as failure to do so would create a situation in which the redundancy procedures would be triggered resulting in someone (who perhaps may have had no involvement in the secondment) being made redundant.

Pension arrangements on transfer

Staff who leave the civil service may preserve their pension rights in the PCSPS or may opt to take a transfer value into the new employer's scheme. Preserved pensions are based on the salary level on leaving the civil service, uprated in line with inflation, so that if an employee's pay in the new employment is expected to rise faster than inflation, for example, on promotion, it may be in the employee's interest, if the terms of the two schemes are comparable, to transfer his rights to the new scheme. The transfer payments brought by transferring staff can be used as the basis of a new pension fund, as in the case of the new company, Hydraulic Research Ltd, employing ex DOE staff. If the conditions of transferred staff are to be preserved, including pension arrangements, it is possible to set up two schemes side by side; one, broadly equivalent to the PCSPS, for staff transferring from the civil service, and another, following more closely private sector practice, for new entrants. Transfer payments extinguish the Government's liabilities in respect of the pensions of transferred employees, so any future liability falls upon the new employer.

MATTHEWS COMMITTEE FOLLOW UP

TRADE AND COMPETITION POLICY ISSUES

SUMMARY OF CONCLUSIONS OF THE WORKING GROUP ON EXPORT POLICY

The Group has analysed the following issues as arising from the Report and its recommendation that ECGD's status be changed to that of a public corporation.

1. Implications for Export Support

The Group concludes that, provided there were to be an appropriate framework in terms of the split of risk between Government and Corporation, suitable financial objectives for each book and adequate resources within the DTI for management control, there is no reason why a switch to Corporation status should affect the availability of support for exporters. The issue of status is largely irrelevant to such questions as the continuation of marginal facilities and the ability to adopt a more discriminating approach to premium setting. The key issue in terms of services to exporters is therefore one of operating efficiency. Given the widespread assumption within the exporting community that a corporation approach is the right one, a decision against a change would need to detail how measures to improve ECGD's operating performance could be secured within existing arrangements.

2. Support for Small Exporters

ECGD's further study of the cost of providing support for small exporters leads the Group to conclude that it is not the case that these costs are being substantially subsidised from premium income from larger exporters. The Corporation, if established, should therefore charge small exporters the full economic cost of administering their policies, introducing the necessary increases on a phased basis.

3. Monopoly and Competition Issues

The Group has considered the competition aspects of the position of ECGD and of the new Corporation, including particularly the arguments for and against giving private sector insurers access to Government support on a similar basis to the Corporation. We conclude that Ministers will need to consider how far any initial legislative and structural arrangements that would be required for the Corporation should make provision for greater competition from the private sector in the medium term, while acknowledging the latter's very limited capacity available at present or within the next decade to provide all the cover that exporters require to compete for overseas business.

4. GATT Implications

Provided that Government's intention is to operate credit insurance in a manner consistent with international practice and at least as commercially as hitherto, any new arrangements can be presented as transparent, and that support is not restricted to particular exporters, sectors or markets, no difficulties should arise within the GATT. However if HMG were to act uncommercially on its own account business over time, there could be problems.

5. Consensus Aspects

We would expect the Corporation to act as technical adviser to DTI, which as sponsor department would lead at OECD Consensus meetings with HMT. The Corporation would undertake the notification and consultation procedures within the EC and the OECD Consensus.

6. DTI Resource Implications

DTI's very initial estimate is that a limited number of additional staff would be required if the Department is to carry responsibility for the sponsorship of the Corporation, the management of the agency arrangements and Consensus policy work.

MATTHEWS COMMITTEE FOLLOW-UP

EXPORT FINANCE: ALTERNATIVE SYSTEMS

SUMMARY OF THE REPORT OF THE WORKING GROUP ON EXPORT FINANCE

Background

1 The Matthews Committee's conclusions regarding export finance were:-

(i) while there would be some advantages in a new export bank in which the Government would have a majority share in joint ownership with the private sector, these would not outweigh the disadvantages;

(ii) ECGD should be enabled to raise funds in its own right for on-lending in certain circumstances;

(iii) every encouragement should be given to development of private sector alternative sources of finance.

2 It is the view of the Group that the Matthews Committee did not give the arrangements for the provision of export finance as thorough a review as is desirable. The present arrangements have worked effectively for many years, and there is naturally some reluctance to disturb them. However, there have been a number of changes in circumstances which at least make it desirable to examine in detail the possible advantages and disadvantages of alternative systems.

The present arrangements

3 From the standpoint of the exporter, the present arrangements have been very effective in providing officially supported export finance. An exporter's concern is to have ready access to finance on the best possible terms in order to maintain competitiveness. However, changes in the Consensus arrangements over the past two years have increased the possibility of financing exports in both sterling and foreign currencies at rates below those in the general matrix of rates, and exporters will want so far as possible to be able to take advantage of this opportunity. The present

arrangements do not encourage the provision of finance at purely market rates of interest with official support limited to credit insurance (pure cover). Difficulty has also arisen due to the absence of an official financing institution through which finance could be provided or channelled in circumstances where a buyer's requirement was for a government to government financing capability.

4 From the standpoint of HMG the present arrangements have four principal drawbacks:-

(i) By providing long-term export finance through the banking system, the arrangements work unfavourably for monetary policy, and contribute substantially to the need for over-funding.

(ii) The present arrangements do little to encourage the use of pure cover, and hence to minimise public expenditure on interest subsidies. The costs of subsidy are, in addition, unpredictable, at least for foreign currency.

(iii) The cost of raising finance through the banking system is higher - by some £50 mn per annum - than would be the case if HMG funded long-term export credit directly;

(iv) The contingent liability to the reserves of the "take-out" arrangements is very large indeed, and therefore a potential problem.

5 From the standpoint of the banks, the present arrangements are broadly satisfactory, although some maintain that their remuneration is inadequate. Unless it can be shown that the alternatives are at least as attractive to them, the banks may well be resistant to proposals for changing a system with which they are content, in which they are widely experienced, and which does not present them with administrative difficulties.

The alternatives

6 No single alternative system for providing export finance would resolve all these issues. There are broadly speaking three major options:-

(i) To retain the present system with or without ECGD having borrowing powers.

(ii) For Government itself to provide long-term export credit.

This would meet most of the problems described in paragraph 4 above and would reduce the cost of interest support. But it would mean that official export finance came within the PSBR (as presently defined), and would do nothing to foster the growth of pure cover.

This option would therefore pose major presentational problems for Ministers, and is likely to be subject to controls over the scale of funding available, which might outweigh the perceived attraction to exporters of this option.

(iii) To establish a private sector export bank which might include a minority government or Bank of England shareholding.

As with (ii) this would meet most of the problems outlined in paragraph 4, but its implications for the cost of official interest support are not clear. Even if this organisation were to receive the official interest support now provided to the banks and thus were to be the source of officially supported export finance, it might also be able to provide finance on a pure cover basis. But there is a risk that any form of official involvement - for example by way of a Bank of England shareholding - could result in its lending being regarded internationally as 'officially supported'.

Views of the Group

7 The Group recommends that the options set out in paragraph 6 (ii) and (iii) should be studied further. The outcome of this study would not impinge substantially on decisions on other aspects of the Matthews report unless the creation of an official financing vehicle were to affect the risk portfolio of the proposed credit insurance corporation recommended by Matthews. If Ministers agree, the existence of a study of alternative arrangements for export finance should be covered in any general statement on the Matthews report. A consultative document setting out the range of options might be issued by the Bank if it were thought helpful for the encouragement of public debate.

8 The recommendation for further study is not intended to affect discussions between ECGD and the Treasury about the acquisition as soon as possible of reserve powers to borrow, whether for ECGD or for a successor corporation in line with Matthews' recommendation.

010

CC PC
NO

NBPM
CDP 16/7.

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

The Rt Hon Norman Tebbit MP
Secretary of State for Trade and Industry
Department of Trade and Industry
1-19 Victoria Street
London SW1H 0ET

13 July 1984

Dear Norman

ECGD POLICY TOWARDS RESCHEDULING COUNTRIES

I agree, as you suggest in your letter of 10 July, that the time has come to review ECGD's policy towards countries that have rescheduled their guaranteed debts - as part of the general post-Summit examination of ways of dealing with the international debt situation.

I think, however, that it will be important first to have some discussion with the other major creditor countries. I have therefore authorised Geoffrey Littler to discuss this subject with his colleagues from other Finance Ministries in the course of various meetings in Paris next week, culminating at OECD's Working Party 3.

I hope you will bear with me if I wait for his report from these international discussions, before I respond to your proposals.

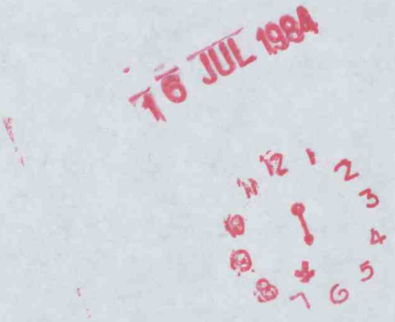
I am copying this letter to the Prime Minister, the Secretaries of State for Foreign and Commonwealth Affairs and Defence, the Minister for Overseas Development and Sir Robert Armstrong.

Yours
Nigel

NIGEL LAWSON

ECGD

16 JUL 1984



J1099

DEPARTMENT OF TRADE AND INDUSTRY
1-19 VICTORIA STREET
LONDON SW1H 0ET

Telephone (Direct dialling) 01-215) 5144
GTN 215)
(Switchboard) 215 7877

From the Minister for Trade

The Rt Hon Peter Rees MP
Chief Secretary to the Treasury
HM Treasury
Parliament Street
LONDON
SW1P 3AG

8 June 1984

Dear Peter,

ECGD: PORTFOLIO SPREAD

Thank you for your letter of 25 May. I very much agree with you that given the sombre background of the continuing debt service problems of many developing countries, the need remains for ECGD to take very careful account of prudential consideration in its Section 2 operations.

I have noted with interest the outcome of the Export Guarantees Committee review of ECGD's country risk exposure, following as it did the wider Financial Review of ECGD's Operations. Given the economic background, the deterioration in the portfolio balance is not surprising, but the situation needs to be watched closely.

Nevertheless I am pleased that over-reaction, which might have caused lasting damage to our trade, has been avoided. The conclusions reached by officials and the proposals agreed upon for further monitoring of the Department's Section 2 portfolio seem to me to be in line with the guidelines established last year and I agree that they are desirable. I have asked my officials at ECGD to act accordingly and to keep me advised of further developments.

I am copying this letter to Members of EX and to Sir Robert Armstrong.

Yours,

PAUL CHANNON

Trade: ECGD Jan 80.



CONFIDENTIAL

C.C. Chancellor
FST
EST
MST
Sir Peter Middleton
Mr Littler
Mr Unwin
Mr Mountfield
Mr Sedgwick
Mr Scott-Barrett
Mr Adams
Mrs Case.

Treasury Chambers, Parliament Street, SW1P 3AG

The Rt Hon P Channon MP
Minister for Trade
Department of Trade & Industry
1 Victoria Street
London
SW1E 6RB

25 May 1984

Mr Turnbull: to see o/r
NBPM AT 30/5

ECGD: PORTFOLIO SPREAD

When we discussed ECGD's Financial Review recently you expressed concern about the gradual deterioration in ECGD's overall portfolio, in particular on the national interest Section 2 account, and the need to improve the existing controls on the Department's exposure on risky markets. Since then I understand that the interdepartmental Export Guarantees Committee has had some further discussion of the Department's "Risk Review" which, under the new arrangements instituted last year in response to the Prime Minister's concern about the extent of ECGD's exposure in poor markets, looks at their portfolio spread.

The review showed a real deterioration in portfolio spread, reflecting both the downgrading of existing markets and risks and also considerable (£1.2 billion) new net liabilities in Section 2 in poorer markets. It was generally agreed that no across-the-board action should be contemplated but that there was a need to improve the existing safeguards and to ensure that any increases in limits were made only after very careful consideration. A number of changes were discussed by officials, including closer monitoring of the portfolio balance including in relation to particular cases, a more selective approach to markets in the C grade and greater use of the risk sharing technique in order to contain demand for cover and import some market test. I hope that you can agree that measures of this kind are desirable. They should help to protect ECGD's financial position (and hence the Exchequer) and thus allow continued support within prudent limits for British exports.

At the same time I think it is worth reminding ourselves of the guidelines on risks which we set ourselves last year in considering export credit insurance risks (set out in Geoffrey Howe's minute of 18 March to the Prime Minister) and the continuing need to weigh carefully the prudential considerations in national interest cases.

I am copying this letter to Members of EX and to Sir Robert Armstrong.

PETER REES

CONFIDENTIAL

DC NO

10 DOWNING STREET

From the Private Secretary

6 April 1984

Dear Steve

EXPORT CREDIT GUARANTEE DEPARTMENT

The Prime Minister has seen Mr. Channon's minute of 2 April. She agrees that the Matthews Report should be published next week, accompanied by a non-committal announcement.

I am sending copies of this letter to the Private Secretaries to members of EX and to Richard Hatfield (Cabinet Office).

Yours sincerely
Andrew Turnbull

(ANDREW TURNBULL)

Steve Nicklen, Esq.,
Department of Trade and Industry.

Treasury Chambers, Parliament Street, SW1P 3AG

Robin Butler Esq
No. 10 Downing Street
LONDON
SW1

6 April 1984

Dear Robin

with AT?

The Chief Secretary has seen Mr Channon's minute to the Prime Minister of 2 April, and has asked me to say that he is content with the proposal to publish the Matthews Report next week. He hopes there will be a chance for Ministers to discuss the recommendations in due course, and agrees that no public comments should be made at this stage.

I am copying this letter to Private Secretaries to other members of EX and to Sir Robert Armstrong.

Yours sincerely

JSt. Gieve

JOHN GIEVE
Private Secretary

8 APR 1984

Prime Minister ①
Agree to publication next week?

CONFIDENTIAL

PPS P'

MR TURNBULL

Yes AT 5/4

5 April 1984

EXPORT CREDITS GUARANTEE DEPARTMENT

The report by Sir Peter Matthews comes down pretty much as expected on the major issue which confronted his committee - whether ECGD should continue as a Government department. The report recommends that ECGD should be replaced ("become" would have been a more reassuring term) by a publicly-owned corporation, which would operate within a new financial structure.

We think that this is a helpful recommendation. Independent status would assist ECGD to operate more commercially and more flexibly (inflexibility was the main criticism levelled against ECGD by exporters). ECGD would be less susceptible to pressure from Government departments to depart from its own commercial judgements, in the "national interest". Risk exposure which ECGD judge to be beyond their capacity to take on would be reinsured with the Government. This would have the advantage of placing the costs squarely where they belong. This would encourage a more realistic approach to such risks, and further the Government's objective of getting paid for exports.

We regard the general sense of the report as helpful, therefore, and see no objection to its publication in its present form, in the non-committal fashion proposed by Mr Channon.

I will be attending a meeting at the Treasury on Friday 13 April to discuss the report.

NICHOLAS OWEN

Nicholas Owen

CONFIDENTIAL

Trade Jan 80

ECGD

V181

CONFIDENTIAL

cc DD
D/F with PM response on Friday 6/4

PRIME MINISTER

EXPORT CREDITS GUARANTEE DEPARTMENT

1 Last August I appointed a committee under Sir Peter Matthews to review ECGD's structure and functions and its present status as a Government Department. The report has now been received, and I attach it. The main recommendation is that ECGD be replaced by a public corporation, but no immediate decision is needed.

2 If you and other members of E(X) agree, I shall publish the report at the earliest date possible, 11 April, with a non-committal announcement by written PQ in the House.

3 I will ask for comments on the Report by July in the hope that we may be able to announce decisions on the recommendations before the Summer Recess.

4 It would be helpful, if possible, to know by 9 April if colleagues are content that I should proceed in this way.

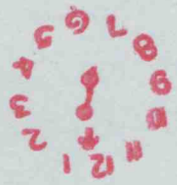
5 I am sending a copy of this letter and the attached Report to the members of E(X) and to Sir Robert Armstrong.

P. C.

2 April 1984

PAUL CHANNON

TRADE : ECGD
Jan 80



REPORT OF THE COMMITTEE TO CONSIDER
THE STRUCTURE, FUNCTIONS AND
STATUS OF THE EXPORT CREDITS
GUARANTEE DEPARTMENT (ECGD)
MARCH 1984

CONTENTS

	Paras.
SECTION I - INTRODUCTION	
Appointment and Procedure	1 - 3
Background ...	4 - 5
SECTION II - SUMMARY OF EVIDENCE	
Perception of ECGD ...	6 - 11
ECGD's Objectives ...	12 - 16
The Export Guarantees Advisory Council ...	17
SECTION III - CREDIT INSURANCE FACILITIES	
General ...	18
International Comparisons	19 - 22
ECGD and the Private Sector Insurers ...	23 - 27
Small Exporters ...	28 - 31
SECTION IV - FINANCE FOR EXPORTS	
The Present Position ...	32 - 34
Possibilities for the Future ...	35 - 38
SECTION V - THE CASE FOR CHANGE	
General ...	39 - 41
Staff Matters and Civil Service Constraints ...	42 - 49
Financial Considerations ...	50 - 52
Export Finance ...	53
The Views of Key Individuals ...	54
Anxieties about Change ...	55
Conclusion ...	56 - 59

	Paras.
SECTION VI - A PUBLIC CORPORATION	
Recommendation ...	60
Functions and Objectives ...	61 - 64
Structure ...	65 - 68
The Treatment of Risks ...	69 - 72
Payment for Other Services	73
Export Finance ...	74
Relations with the Private Sector ...	75
SECTION VII - MANAGEMENT MATTERS	
General ...	76
Organisational Matters ...	77 - 79
Operational Matters ...	80 - 85
SECTION VIII - THE TRANSITION PERIOD	
A Programme of Action ...	86 - 87
SECTION IX - SUMMARY AND CONCLUSION	
The Present Situation ...	88
Principal Recommendations	89 - 91

	Appendix
List of Bodies which provided Evidence	A
A Comparison of the Export Credit Insurance Facilities provided by ECGD and other major Overseas Credit Insurers ...	B
Private Sector Insurance for the Exporter or Overseas Investor ...	C

REPORT OF THE COMMITTEE TO CONSIDER THE STRUCTURE, FUNCTIONS AND STATUS OF THE EXPORT CREDITS GUARANTEE DEPARTMENT (ECGD).

To the Right Hon Paul Channon PC, MP, Minister for Trade.

I INTRODUCTION

Appointment and Procedure

You appointed us on 16th August 1983 with the following terms of reference:-

"to review ECGD's structure and functions and its present status as a government department, taking into account in particular - the importance to UK exporters of the quality of the credit insurance and financing facilities provided by ECGD compared with those available to their competitors; the taxpayer's interest in containing the actual and potential costs of ECGD's operations; and the possibility of devolving any functions to the private sector or collaborating with the private sector in carrying them out."

2. We held our first meeting on 9th September and have since held 41 further meetings, including visits to the Department's offices at London, Cardiff and Birmingham, and to Hermes Kreditversicherungs - AG ("Hermes") in Hamburg, GFR and a visit from the Export Development Corporation of Canada ("EDC"). Evidence, in some cases both written and oral, was submitted to us by the government departments principally concerned, the Bank of England, organisations representing industry, commerce, banking and insurance, as well as by ECGD itself, by the Trades Union side of the Departmental Whitley Council and by individuals with close knowledge of the working of the

Department. A list of those who provided evidence is in Appendix A. We would like to record our appreciation of the assistance rendered to us by all who gave readily of their experience and views, and of the assistance we received from the Department itself.

3. We interpreted our terms of reference broadly. We did not concern ourselves with the more technical aspects of the Department's operations beyond the extent necessary to enable us to consider the scope of its functions, the structure appropriate to those functions and the status best suited for carrying them out. We also had available the views expressed by committees which had reviewed aspects of ECGD in earlier years, notably the Committee on the Organisation and Status of the ECGD, under the chairmanship of Sir Eric Speed, KCB, KBE, MC, in 1958 and the review of the Department led by Mr D G Scholey in 1972.

Background

4. ECGD is a separate government department within the Trade and Industry Group which is responsible for administering the powers conferred on the Secretary of State by successive acts of Parliament since 1919, currently the Export Guarantees and Overseas Investment Act 1978. These enable the Department to pursue activities in two principal areas designed to encourage trade with or facilitate investment in overseas countries. The first concerns the giving of guarantees, the outturn of which is reflected in the Department's annual accounts. The other concerns the operation on behalf of the Exchequer of certain other facilities in support of United Kingdom exports, the most notable of which is interest equalisation in respect of finance made available by the banks. In the former area ECGD is required to operate in the longer term at no net cost to public funds. This it has achieved by charging adequate premiums so that its income, which includes notional interest earned on cash balances built up and held in the Consolidated Fund, has been

sufficient to meet its administrative costs and the cost of claims payments less amounts recovered from debtors. Its guarantees cover very large amounts (over £42 billions at December 1983), including some denominated in foreign currencies. However, its cash reserves are all in sterling. Despite recent growth in the facilities available in the private sector for insuring overseas commercial credit risks, ECGD continues to occupy the predominant position in the United Kingdom in this field. It is alone in providing support through the banks for raising export finance.

5. An important aspect of the background to the Committee's considerations was the unprecedented financial situation of ECGD. The Department's involvement in support of United Kingdom exports covers one-third of visible exports, including a very high proportion indeed of major project business. Trading conditions have worsened in recent years and a number of countries, as well as individual enterprises, are facing severe problems in meeting their payment obligations. The effect of the resultant very high levels of claims payments on the outturn of ECGD's trading activities has been significant. It was not part of our mandate to examine or comment on the Department's current financial position but in making our recommendations we could not ignore it.

II SUMMARY OF EVIDENCE

Perception of ECGD

6. The evidence submitted to us showed a wide appreciation of the Department throughout the exporting community. It enjoys a high reputation among exporters (especially those involved in major projects) and in the banking and commercial sectors for the way in which it discharges its responsibilities. It has been regarded in other countries as a model to be emulated. ECGD has been seen as responsive to commercial needs and appears to have developed its facilities and adjusted to market requirements to a commendable extent, given the constraints upon it to which we refer in Section V.

7. However, doubts have been expressed about some aspects of the Department's more recent performance. The evidence contained repeated criticisms reflecting concern among exporters, most notably about delays and complexity of procedures in connection with ECGD's comprehensive guarantees covering exports on short credit terms, and the lack of flexibility in the Department when providing and charging for its guarantees of various kinds. A number of organisations, particularly banks, expressed a wish for earlier consultation by ECGD about proposed changes in its facilities. Many exporters spoke particularly of problems posed for them by the Department's inflexibility, just prior to and on its withdrawing cover for a country and when restoring cover is in prospect. A number of those giving evidence, especially some major exporters, drew attention to the high levels which total premium charges can now reach. They were worried about becoming uncompetitive if further increases were to be imposed on future guarantees, in an effort to recover the considerable sums recently paid against claims under ECGD's existing guarantees.

8. The exporting community attaches great importance to the undoubted standing of ECGD's guarantees (which results from their being given by "the Secretary of State" on behalf of the government) and to the benefits which follow from that. Equally there is a wide recognition of the importance of ECGD as an instrument of the United Kingdom's economic and overseas trade policies.

9. There is no evidence that the private sector could provide the equivalent of ECGD's existing services or that the bulk of ECGD's activities could be transferred to the private sector. It does not appear to have either the capacity or wish to take them on, although there is a desire to play a greater part in export credit insurance and for closer co-operation. There is agreement that sufficient finance for exports at competitive fixed rates of interest is unlikely to be made available without the interest rate support from government which is currently provided through ECGD.

10. The evidence showed that there are significant advantages, for exporters and for the Department itself, in its current status as a department of central government. However, there was also strong evidence that its efficient operation has been hindered recently by its being required to comply with rules and measures applying to government departments and the civil service as a whole. We refer to this in more detail in Section V.

11. We found a widespread feeling in the exporting community, with one or two notable exceptions, that some degree of change is desirable in the way ECGD discharges its functions. On the other hand, there was no call for any substantial changes in the functions themselves. There was general agreement that any change would have to be so managed as to avoid disruption of ECGD's normal day to day activities. Most exporters foresaw a period of sustained international competition during which their needs for support will become greater and more complex and thus require the best possible service from the Department.

ECGD's Objectives

12. We heard much about the inherent conflict between ECGD's statutory duty to encourage trade by giving guarantees, including trade to be encouraged "in the national interest", and the requirement of government policy that it should seek to operate its guarantee activities without cost to public funds. Until recently the Department was able to meet both of these objectives without difficulty, at least on a short-term basis, but the deteriorating world trading environment of the last few years has made this an increasingly difficult task. Other government departments have an interest in or a responsibility for the promotion of overseas trade or for control of the public purse but we are not aware of another which, like ECGD, has specific duties laid upon it in both respects.

13. There are considerable benefits which flow from overseas trade but when payment is not received there is a cost that has then to be met. Initially, the burden of any insured non-payment falls on ECGD who eventually must pass it on to its policyholders through increased premiums, if there is to be no call on public funds. Thus the costs of ECGD's encouragement of that trade may fall on exporters across the whole range of its services.

14. The conflict for ECGD is most obvious in the inter-departmental discussions about support to be given under section 2 of the Export Guarantees and Overseas Investment Act to exports "in the national interest". We recognise that ECGD's own obligation to encourage trade inevitably must affect the degree to which it feels able to press its role as a prudent insurer, but on occasion its view of the risks involved may be outweighed by a majority view by other departments of the benefits to accrue. Although ECGD has a right to have the matter referred to Ministers, it has no right of sole decision to match its responsibility for the consequences. As a result, in some instances ECGD has been persuaded by pressures applied by other departments to give support to certain exports (including some

major projects) contrary to its own initial judgment. Nevertheless, the cost of such support is included, in the same way as for other exports, in ECGD's accounts.

15. Many organisations expressed their appreciation of the way in which co-ordination between ECGD and other government departments provides a wide range of support particularly for major project exports. A number, including the British Overseas Trade Board, represented to us that in future there will be an even greater need for a strong focus for the United Kingdom's export effort.

We learned of problems in one area in which close collaboration is required between ECGD and other departments, as well as exporters and banks, namely the facilitating of mixed credit packages to be offered by United Kindom exporters in competition with similar financing on offer from other countries. These packages combine ECGD-supported finance with funds made available from the Aid and Trade Provision - a part of the funds disbursed by the Overseas Development Administration of the Foreign and Commonwealth Office. We received proposals for the use of government aid to further exports of military equipment. The United Kingdom's long term policy is to discourage the use of such techniques in the area of trade. Not all countries take the same attitude.

16. A number of organisations represented to us that the co-ordination of the elements of such packages in the United Kingdom, involving principally HM Treasury, the Department of Trade and Industry, the Overseas Development Administration and ECGD, does not allow the flexibility of approach and speed of reaction which appears to be available to competitors in other countries. They suggested that responsibility within government for the provision and terms of such packages should become the concern of a single department.

The Export Guarantees Advisory Council

17. The present role of the Export Guarantees Advisory Council is recognised generally as valuable and most helpful to ECGD, but it is limited almost entirely to the giving of advice on specific matters submitted to it by the Department, although in 1981 it did carry out and submit to your predecessor a review of some wider aspects of ECGD's activities. We observed a widely-held view, shared by the Advisory Council itself, that its role should be reconsidered and adjusted to include some concern for the management of the Department and for the quality of the services it provides.

III CREDIT INSURANCE FACILITIES

General

18. There does not appear to be any significant need by United Kingdom exporters for credit insurance facilities which are not available from ECGD or the private sector. Needs for specialist new facilities which arise from time to time have generally been met. ECGD's own facilities are comprehensive and widely known. Although there are some criticisms, to which we referred in paragraph 7, about the way in which ECGD operates and markets its facilities, they are regarded generally as being suitable for their purpose.

International Comparisons

19. In considering that part of our terms of reference which required us to compare ECGD's credit insurance and financing facilities with those available to competitor exporters from other countries, we had available information supplied to us direct by Hermes and by EDC, as well as that provided by ECGD itself and a number of others who gave evidence mainly based on their own particular experiences. A factual comparison of the facilities offered by ECGD and members of the International Union of Credit and Investment Insurers (the Berne Union) in the United Kingdom's main competitor countries is in Appendix B. In comparing the facilities it is necessary to pay regard to the different ways in which exporters are accustomed to conducting and financing their export trade.

20. We are satisfied that the facilities offered by ECGD compare favourably with those on offer from other countries' export credit insurance organisations.

21. For business on short credit, ECGD's range of insurance facilities is very wide and the only significant omissions from its facilities, compared with those available in some other countries, are that separate insurance of political or commercial risks is not available as an option and that there is no formal differentiation in applying premium rates to private buyers and public entities. In relation to major contracts on longer credit terms, where fierce competition exists, comment was made to us about the use by other countries of particularly favourable credit terms. The Department does not initiate credit competition, but we believe that it has generally been enabled to match others. In practice the worst difficulties experienced by United Kingdom exporters in matching competitors' terms have involved those countries whose credit insurance organisations are not members of the Berne Union.

22. Wide differences exist in the ways in which finance for exports is made available. The system of providing fixed interest finance through banks mainly against guarantees from ECGD, plus an interest equalisation arrangement, so far has worked well for United Kingdom exporters, although recently this has been at a high cost to public funds.

ECGD and the Private Sector Insurers

23. We received evidence concerning facilities provided by the private sector insurers, from the insurance market, exporters and industry associations, and from the Department. There was general agreement that, whilst there had been an increase in private sector activity, particularly noticeable recently, the extent to which this had significantly affected ECGD's own level of business and so sharpened competition to the benefit of exporters was still modest. Unfortunately few statistics are available to confirm recent trends, but the figures given informally by a number of insurers provide support for this statement. A summary of the main aspects of the private sector market is given in Appendix C.

24. In the course of evidence we enquired particularly as to the reason for the absence of more rapid developments in the private sector, given the attention that this matter had attracted and the discussions held between the Department and interested parties over the last few years. The main reasons suggested to us were:

A. Only ECGD is able to offer insurance for both commercial and political risks combined with access to finance at favourable rates. The private sector's policies do not include both the former, except on a restricted and limited basis, and it could not compete with the latter. For many risks the private sector offers no adequate alternative.

B. ECGD's major policyholders often have strongly based relationships with the Department which they do not wish to jeopardise.

C. Whilst ECGD's Comprehensive Short Term Guarantee policy, erroneously described as "whole turnover", has been modified over the years and now allows much less than the whole of an exporter's business to be insured, it still tends to inhibit exporters from moving part of their business to the private sector, in case this leads to a review by ECGD of the terms of its insurance and the premium rates.

D. Whilst policies of a comprehensive nature are offered by a few private sector insurers, the market generally operates through highly flexible and individual contracts based on insurance against buyer default and loss to the insured. These may be suitable for large contracts but are much less so to the short term mass market which still dominates United Kingdom exports.

E. As a result the private sector has tended to provide cover for risks which ECGD either does not provide or does so less

flexibly or at higher cost. We heard of cases where exporters found it cheaper and simpler to insure commercial risks with private insurers when no political risk was involved, and where investors were able to obtain more extensive insurance for existing investments than is available under ECGD's Overseas Investment Insurance Scheme.

F. ECGD's goodwill towards the development of the private sector as a contributor to the promotion of United Kingdom exports was generally acknowledged. However, the Department's wish to ensure that its underwriting portfolio is well spread, not unnaturally, inhibits it from encouraging the private sector to take as large a share of total exporting risks as the latter appears capable of absorbing.

25. We were told of the extent to which others had found it worthwhile either co-insuring or re-insuring on the London markets. Co-insurance is a technique the Department should investigate. The question of reinsurance involves a more basic change in policy for the Department, which we discuss further in Section VI.

26. There must be significant advantages in encouraging the maximum contribution by private sector insurers in support of United Kingdom exports. It was suggested to us that, in offering a greater choice to exporters, it could lead to lower premium costs and, with the elimination of some cross-subsidies which exist within ECGD's current arrangements, to a fairer or more realistic system of charging than at present. However, the extent to which private sector insurers could absorb the relatively massive risks covered by ECGD is uncertain: in particular their capacity for insuring risks in the politically less certain markets is limited and seems likely to remain so.

27. We became aware of the difficulty for ECGD, as it is now constituted, in reacting competitively to the potential impact of any significant diversion of business to the private sector

which might ensue, for instance, from the separation of political from commercial risk insurance. The Department fears that the loss of some of its better business would inevitably lead to its having to increase premiums on that remaining. Encouragement of the private sector and increased effectiveness and efficiency at ECGD would need to move together. We foresee a continuing need for a healthy ECGD as the principal provider of export credit insurance to United Kingdom exporters.

Small Exporters

28. We received a considerable amount of evidence on the use of ECGD's services by the so-called "small exporter" and the problems which many of them experience with the complexities of documentation and procedures. There was no common line on how one could define small exporters. They include not only small companies but also a number of medium or large ones which export, or insure with ECGD, only a small proportion of their output. Her Majesty's Government has a large number of schemes to encourage small businesses generally. To the extent that those small businesses are also exporters, these schemes offer help to small exporters, but none of them has a specific export orientation; nor are they available to larger businesses who only export relatively little.

29. There was a widely held feeling that the services provided by ECGD and the premiums charged to the larger exporter were adversely affected by the proportionately greater amount of time and cost devoted by the Department to servicing the small exporter. Figures provided by the Department gave substance to these views. Over the five years to 1983, all but the largest of ECGD's comprehensive short term guarantees, taken overall, failed to contribute enough to cover their share of administrative expenses and of claims payments. This disparity was most marked for the smallest policies; for instance, almost 40% by number of such policies related to

annual exports of less than £100,000, produced less than 3% of the premium income, and accounted for nearly 20% of the administration costs. There was no significant difference in the incidence of claims between small and larger policies. The high turnover in numbers of small policy holders, a significant proportion of which each year are new exporters, is a major reason for these disproportionate administration costs. It was suggested by many of those giving evidence that there should be restrictions, based on minimum turnover, on the support available to small exporters.

30. In recent years some of the London clearing banks have introduced schemes whereby "small exporters" can obtain credit insurance under the banks' own ECGD policies. Evidence suggested that, although welcome, so far these had been only modestly successful in view of pricing and profitability problems and the limitations to business which could be written under present ECGD policies. We also heard of similar facilities available from export and confirming houses. Whilst cover is available from private insurers, premiums in general reflect the high costs of this sort of business. Thus, comparatively little business is done.

31. We believe that it is desirable - and indeed in line with government policy - that United Kingdom companies should be helped to begin exporting. However, this should not entail ECGD providing additional non-insurance services at the expense of existing exporters, as would seem to be the case now. In paragraph 73 we argue that voted funds from government should be available to provide a contribution to the costs of advice and other services provided beyond ECGD's obligations as an insurer. We recommend that this should be used to support a positive policy of seeking ways in which the private sector can assume a major part in the provision of simpler and better services to the small exporter, along the lines indicated in paragraph 30.

IV FINANCE FOR EXPORTS

The Present Position

32. The provision of facilities to support financing for the exports that it insures is an important part of ECGD's activities and a vital ingredient for United Kingdom exporters and contractors where major projects are concerned. This support has been undertaken almost entirely through the Department's comprehensive and specific bank guarantee and buyer credit facilities, the latter two of which hitherto have been virtually the only means in the United Kingdom of obtaining fixed rate export finance. The minimum fixed interest rates applicable to officially supported export finance are agreed by the member countries of the OECD "Consensus". In the United Kingdom the export finance is provided by the banks and the government has met or charged to the banks the difference between such rates and the prevailing market rates. This support scheme, as we said at paragraph 4, is operated by ECGD. During most of the last decade market interest rates in the United Kingdom have far exceeded Consensus rates for the major currencies. The government has encouraged the diversification of export finance out of sterling into a wider range of currencies. The banks would not have been able to provide the required fixed rate finance without official support. In many cases, however, the banks do provide front end finance at floating rates without ECGD support.

33. The cost to public funds of this interest equalisation scheme operated through ECGD as agent has been very high in recent years (£585.4m in 1981/2) though it is now falling, partly as a consequence of the recent changes in the international Consensus to which we refer at paragraph 35 (and is estimated at £324m for 1983/84). This fall seems likely to continue although future costs are dependent largely on movements in interest rates.

34. Other countries use a variety of methods for financing their exports; through guarantees to banks, as in the United Kingdom; partly through special banking institutions as in the United States; through combining the direct provision of finance in the same institution with credit insurance as in Canada, or direct from private sector banks. We have received a number of suggestions that one or other of such methods might be appropriate to the United Kingdom.

Possibilities for the Future

35. The recently revised Consensus arrangements provide for periodic automatic adjustment of agreed minimum interest rates in line with average market levels. Although as yet untested, this development, together with the prospect of lower and possibly less volatile market interest rates, represents a significant change in the financial environment, and demands a re-evaluation of the methods of financing United Kingdom exports. The use of private sector financial resources is likely to become once again of much greater importance in arranging competitive export finance packages.

36. We heard of private sector initiatives and proposals in this field, particularly in the use of the bond markets to fund longer term fixed rate finance for specific export contracts. Such initiatives are much to be welcomed, although we believe that ECGD's guaranteed schemes will continue to have a major role for the foreseeable future in the export financing market. However, given the scale of the finance required and the likely problems in matching requirements as to currency and rate, it will be important that every encouragement is given to development of alternative forms of finance through both the banking system and the markets generally.

37. We consider that it would be a relevant and important development if ECGD were enabled to raise funds, primarily at

fixed rates, in its own right, either for specific projects or for "stock" for future lending requirements as they arise. Whilst initially such a mechanism probably would be needed only for certain currencies with low interest rates, its extension to other currencies, including sterling, should not be ruled out for future use. The name of ECGD would normally command the finest rates in the market in the same way as Her Majesty's Government itself. Clearly any implications for monetary policy and the effect on the Public Sector Borrowing Requirement, as currently defined, would have to be taken into account, but we hope that they would not be an obstacle to improving the competitive facilities available to United Kingdom exporters.

38. It was suggested to us that a new export bank should be set up with the government having a majority share in joint ownership with private institutions. Whilst this would have some attractions, we believe that these would be insufficient to outweigh the disadvantages of creating yet a further institution which would become another separate element in the exporter's negotiations. Our proposal that ECGD itself should be able to adopt a limited financing role would have the real advantage of retaining as far as possible a "one stop" service for the exporter seeking support for finance and provide the best prospect of a speedy and flexible response to his needs.

V THE CASE FOR CHANGE

General

39. In considering all the factual information provided to us and the expert views and opinions expressed, both in written evidence submitted and in response to our oral questions, we considered first of all whether, in the context of present and likely future trading conditions, any change in the status of ECGD would be desirable. It seemed to us at the outset that this decision would be likely to have a major bearing not only on our consideration of the Department's credit insurance facilities and the important allied matter of the provision of finance for support of exports, but also on the way we should approach a number of managerial, organisational and operational questions posed by the evidence: in short, on its structure and its functions.

40. Although there is some scope for increased private sector activities, it is clear that the private sector cannot be expected to take the place of ECGD or take over altogether any of its present activities. Neither do we see any scope for transferring a part of those activities to a new private sector organisation.

41. However, we conclude that there is now a strong case for a change of status of the Department. We see this case as being made not by one overwhelming argument, but by a number of factors which in our opinion all point in the same direction. We are conscious that earlier reviews of this question came to different conclusions. However, we believe that the balance of advantage has changed and we expect future developments to reinforce this change.

Staff Matters and Civil Service Constraints

42. In paragraphs 6 and 10 we referred to views on the constraints imposed on ECGD because it is a civil service department. We have discussed some specific and general points relating to this with those who gave evidence including retired and present senior executives of the Department, and we are satisfied that these views are substantiated and that the constraints have in fact had a damaging effect overall on the operations of the Department. We feel that its senior executives do not have sufficient freedom now to manage the business as effectively as they might.

43. The move of about 700 posts within the Department to Cardiff in 1979 and 1980 was undertaken as part of government policy to disperse jobs from London. It has secured some financial savings, but at the cost of losing some expert staff and dividing the Department, to the considerable inconvenience both of its customers, some of whom now must often visit both Cardiff and London to discuss problems, and of the more senior staff of the Department, who necessarily waste much time travelling. Subsequently, there has been much discussion on various measures to remedy the problems caused by the move, some of which probably cannot be solved within the present structure.

44. It is clear too that the staff cuts made in ECGD in recent years, though below the average for the civil service as a whole, have by their arbitrary nature been disruptive and have resulted in delays in handling the much increased volume of claims and in responding to the needs of the Department's customers. These cuts might have been sustained with less difficulty if at the same time ECGD's data processing system had been developing more quickly (see para 46).

45. We have noted that a number of good quality experienced staff have been lost to the private sector in recent years and that the Department has been unable to replace them by staff of

appropriate standing and experience through recruitment either from outside the civil service or within it. Some secondments from outside can be helpful but it should not be necessary to rely on this procedure to make up staff deficiencies.

46. ECGD has a well established computer and data processing unit at Cardiff handling some aspects of the Department's business. However, during recent years the further development of these facilities, to embrace such matters as credit control and the issuing of policies and to bring data recovery systems onto the desks of individual underwriters, appears to have lost some momentum. The existing facilities do not seem to us to be as advanced as those of most private sector insurers. There is a likelihood that unless a substantial and determined effort is made to accelerate progress in this field, ECGD will fall further behind, the more so as the leaders' greater expertise and facilities accelerate their progress. It is natural that, with the present status of the Department, the development of these facilities has been compared to progress elsewhere in the civil service. We recognise that the Department cannot expect special treatment on the grounds that it is "different". Nonetheless, its needs should be assessed by reference to the commercial nature of its operations.

47. As mentioned in paragraphs 7 and 16, we received many pleas from those who gave evidence that greater flexibility be shown by the Department. These covered a wide range of matters from the difficulty of establishing the need to match credit terms offered by other countries on large projects, to procedural matters relating to exporters' claims etc. where individual customers wanted their own problem, which they often saw as simple or unique, to be handled separately and expeditiously. There is little doubt that departmental procedures, which have much of their origin in civil service practice, tend towards uniformity rather than flexibility of response. As a government department, ECGD feels inhibited from discriminating adequately between one exporter and another for similar business, even where their individual needs differ.

48. ECGD, as a government department, has a strongly developed and rigidly organised hierarchical structure which means that it is not easy for it to act as a whole in a commercial manner, or to adopt the competitive role which we believe desirable at the interface with private sector insurers.

49. The effects of these constraints have recently become more noticeable and we do not believe that they are likely to be removed by making any series of special rules or exemptions from existing practices within the civil service.

Financial Considerations

50. The recent very high level of payments against claims has caused a diminution of ECGD's Consolidated Fund balance to the point where, for the first time in many years, it has gone into deficit, a situation which seems likely to persist for some time. In our view, it would be regrettable if, as a result, too much emphasis was placed on ECGD's cash position. We fear the consequences would be to cause the Department's underwriting judgments to become too restrictive and premium rates to rise steeply. Both of these effects would operate to disadvantage the United Kingdom's future trade prospects at a time when the priorities are to reverse the decline in its share of world trade and to improve competitiveness by reducing exporters' costs in every way possible.

51. The operating costs of the Department and its staffing levels are substantial. We consider there is some scope for reducing them and the costs to exporters and, at the same time, offering a more comprehensive service, as a consequence of promoting fair competition between the Department and private sector insurers (see also paragraphs 26 and 30). The recommendation in paragraph 31 relating to small exporters will, if implemented, have two significant effects: a reduction in the Department's costs and representation requirements in Cardiff and the regional offices, and an improvement in service to the medium-sized and larger exporter.

52. We considered a number of other matters relating to the finances and accounts of the Department. In regard to financial matters, we consider that with a change in status the handling of foreign exchange could be improved, with an option of seeking market protection to balance risks expressed in foreign currencies. Also there would be less restriction on the investment of accumulated reserves.

Although a number of changes have been instituted recently to make the accounts more like those of a commercial organisation, a change in status should allow further developments which would achieve a welcome improvement in the transparency of the operations. This for instance would be likely to reveal and subsequently lead to a reduction in cross-subsidies between different facilities.

Export Finance

53. As we make clear in section IV, we consider that future developments in the export finance field are likely to require greater flexibility and scope in the techniques of provision of finance. This could be of value both in promoting exports and in reducing to some extent the cost, or at least limiting the uncertainty of ultimate cost, of the government's support. It seems clear that the flexibility required, particularly for raising finance, could not be achieved easily within the limitations of a government department.

The Views of Key Individuals

54. We were left in no doubt that the need for a change in ECGD's status was perceived not only by outsiders but also by the Department's present top management and other individuals who had recently been involved at high level in its management and operations. They stressed, however, that any new arrangement would have to incorporate safeguards designed to enable EGCD to maintain a broadly-based service to exporters.

Anxieties about Change

55. A number of anxieties about the prospect of a change of status were expressed to us, reflecting concern to continue some of the most desirable features of ECGD's present constitution. These features were seen as being the quality of the government's guarantee, the close involvement of ECGD in the formation of government policy, and the Department's access to the information it needs from official and international sources.

Conclusion

56. We foresee that there is likely to be a long period of intense international competition for export markets and almost certainly no better than a gradual lessening of the present international financial strains. Exporters will look to the government's support services to help them stay competitive. Flexibility and speed of response will remain vital elements in seeking business, whilst the complexity of credit and financing aspects continues to grow. It is to these aspects that ECGD's own response will often be crucial.

57. We see that, as presently constituted, ECGD is not best placed to respond to the challenge. It is the repository of much specialised experience and knowledge which can be of immense value to the exporting community, but there are constraints on its freedom to deploy them to the best advantage.

58. The change in status that we recommend should lead to a more competitive, entrepreneurial and efficient organisation, which would compete in part with the private sector to the benefit of both, and hence to exporters. It would also co-operate with the private sector in reinsurance, thus widening the pool of resources available and spreading risks. However, as we have said, we see no arguments for transferring ECGD's activities, in whole or in any major part, to the private sector. The importance of the government's

backing for its guarantees means that it must remain in the public sector.

59. The financing and financial objectives of ECGD are now being widely discussed. We consider that this is a particularly opportune moment for Her Majesty's Government to give a clear signal of intention to continue to give a strong lead in promoting and facilitating exports. The Department's role is central to achieving this purpose. We believe that the proposals we make, which are aimed at reducing frustrations and promoting competition where appropriate, provide an opportunity for such a signal.

VI A PUBLIC CORPORATION

Recommendation

60. We recommend that ECGD be replaced by a publicly owned corporation answerable to the Secretary of State for Trade and Industry. Although such an organisation would operate independently in its day-to-day activities, all the obligations it assumes would need to have, and be seen to have, the full backing of Her Majesty's Government. The change of status should be supported by a statement at the outset of the government's intent that the new corporation should undertake all ECGD's present responsibilities to the exporting community and to government.

Functions and Objectives

61. We regard it as particularly important that ECGD's functions as at present, or expanded as we propose herein, should not be sub-divided but that the whole should be retained within one organisation. The new corporation should continue to act for itself, and where appropriate on behalf of Her Majesty's Government, in the Berne Union and other international bodies.

62. The corporation should continue to have full access to diplomatic and commercial posts overseas and to Her Majesty's Government's information relating to overseas trade prospects and risks.

63. It should be unnecessary for any other government department to replicate any of the new corporation's activities.

64. The purpose of the new corporation should be to provide insurance and financial services in support of exports, and to do so at a profit. We believe these purposes are compatible, given the arrangements we propose below.

Structure

65. The new corporation should have a board of directors with statutory responsibilities, replacing the present Advisory Council arrangements. The board should include representation of Her Majesty's Government at very senior level by HM Treasury and the Department of Trade and Industry, as well as of the financial and exporting community.

66. It would be necessary to capitalise the new corporation adequately for its likely needs. The capital would have to be considered in relation to both the expected retained annual premium income and the solvency requirements which we understand are being proposed to the Council of the European Community. Regard would also have to be paid in the first instance to the extent to which ECGD's existing risks become reinsured with the government or in the market (see paragraph 70).

67. We are aware of the prospect that ECGD is likely to have a substantial deficit in its notional cash balance with the Consolidated Fund during the period of any change. However, it has large reserve assets, and with these the new corporation should be enabled to finance its cash requirements through refinancing with the public or private sector.

68. An objective of the new corporation should be to invest its reserves within such prudent guidelines as its board considers most appropriate.

The Treatment of Risks

69. The corporation should be required to operate within the financial structure thus set up. In particular, it would be for its board to determine its capacity to carry risks on its own account, having regard to its capital base and the balance of its portfolio, and to carry responsibility for its charging adequate premiums.

70. The corporation should have the power to reinsure risks, either with Her Majesty's Government or with private sector insurers, as a means of increasing its capacity to insure risks in particular markets or overall. Her Majesty's Government should make available to the corporation reinsurance, on a treaty basis*, of either the commercial risk or the political risk or both together. This would be used in two ways: in those cases which the corporation regarded as insurable risks, but which exceeded its own capacity, it would reinsure the balance of the risk; in those cases which did not meet the corporation's criteria, but which it was decided should be insured in the national interest, it would underwrite the business and reinsure it wholly with the government. The corporation would pay the government for such reinsurance a premium representing the appropriate share of the original premium, less a commission to cover its handling charges. We consider that initially and for some time to come the corporation should have the sole right to reinsure risks with the government, but that the possibility of private sector insurers having the same facility at some time in the future should not be ruled out.

---

*Treaty Reinsurance: A widely used form of reinsurance involving the automatic cession of business within a certain class by the ceding company and the automatic acceptance by the reinsurer of all the business ceded for a stipulated period of time. Under such an arrangement the corporation would prepare and keep accounts for the government of those risks which the latter reinsures and would administer the insurance policies, including the handling and payment of claims.

71. The Export Guarantees Committee, or a similar interdepartmental committee, should continue to meet with the chief executive of the corporation (in place of the Secretary, ECGD) to co-ordinate the relevant government policy. Whilst the corporation would determine its own limits of risk exposure by country, the committee would determine the government's limits of risk as a reinsurer, taking account of the risks accepted by the corporation within its own capacity. The committee would also agree, or determine a reference to ministers, on support for business in the national interest.

The commercial interests of the corporation will put pressure on the members of this committee to recognise the costs and consequences which may flow when they ask the corporation to provide its facilities on a basis which the corporation would not itself otherwise propose. We suggest that a sponsoring department should be required to accept on its vote any costs of the eventual outturn of the reinsurance of such business.

72. We believe that it would be not merely advisable operationally, but in the long run better for trade, if ECGD and the new corporation were to charge more realistic individual premium rates and discriminate more between one risk and another than the Department now feels able to do.

Payment for Other Services

73. We suggest that the new corporation should receive a contribution from voted funds towards the cost of its activities on the government's behalf in administering the interest rate support scheme or any other scheme it is required to operate outside its credit insurance or financing functions. Similarly, it should not be required to meet from its own resources the cost of advice and other services it provides to small exporters beyond its obligations as an insurer, including any special services it may provide in future in association with the private sector.

Export Finance

74. The corporation should, as we propose at paragraph 37, be enabled to raise funds, primarily at fixed rates, in its own right and on its own account.

Relations with the Private Sector

75. In the interests of efficiency and hence the best support of exports, we would favour a programme of action to stimulate both co-operation and competition with the private sector by the corporation, and the removal of any present constraints to competition. For instance, we hope that in due course the corporation would feel able to offer to individual private sector insurers carefully designed packages of reinsurance of political risks, or of both commercial and political risks, at appropriate premium rates.

VII MANAGEMENT MATTERS

General

76. A number of points which arose during our consideration of the evidence are not appropriate for specific recommendations by this committee, but are matters to be tackled by management.

Organisational Matters

77. The corporation would need to begin by taking on all the staff of ECGD. Thereafter the corporation would be responsible for its own employment and recruitment policy without constraints. A number of transitional arrangements would have to be made, such as those with the relevant trades unions, and those related to existing and future pension rights of staff.

78. It would be for the management to consider whether, for instance, any degree of reversal of ECGD's move to Cardiff would be beneficial, or whether there should be any changes in the level or functions of the regional representation; and if so, when.

79. It is clear there is leeway to be made up in regard to the use of data processing equipment, which will be dependent on adequate financial resources in the first instance. In due course the development of such processes will impact upon both manning and cost levels.

Operational Matters

80. The corporation would have more freedom in its underwriting operations than ECGD believes it has at present. This greater freedom would have to be exercised with care, particularly where the corporation has a monopoly position, but it should lead to greater flexibility and speed of response.

81. Reference was made to the Department's present lack of flexibility when coming "off cover" for a market, to which we referred in paragraph 7. We appreciate the reasons why prior notice of withdrawal of credit insurance cover cannot sensibly be given, but this is an area where management should be able to make use of greater freedom to discriminate between cases when insufficient cover is available, taking account where appropriate of specialist advice and of the longer term outlook.

82. Other leading export credit insurers charge lower premium rates for business with public sector buyers (see paragraph 21). We suggest that, although the corporation may not wish to adopt the same approach generally, its management might nevertheless feel more ready to discriminate in this way on some individual contracts where the competitive position of the exporter seems particularly to require it.

83. In those areas where the corporation would be in direct competition with the private sector, management will need to improve service in such ways as dealing more expeditiously with claims and credit limit enquiries, and simplifying procedures and documentation to the benefit of all policy holders.

84. A more commercial approach to marketing is required. Representatives of the broking community expressed their readiness to assist in such a programme by ECGD but it is apparent that, as a government department, ECGD has hesitated to appear to be competing too strongly for new business.

85. Specialist resources are available in the private market, covering such activities as collecting overdue payments (whether or not the the insurer has paid a claim), the provision of backing for recourse to companies in the United Kingdom or assessing their recourse-worthiness, and in the area of debt refinancing. The use of such resources, to a greater extent than ECGD is doing now, might well be justified.

VIII THE TRANSITION PERIOD

A Programme of Action

86. If our recommendations are accepted and their implementation is to be conducted smoothly, a comprehensive programme of action would need to be planned and co-ordinated before a vesting date for the new corporation. It is of prime importance that the programme be carried through to completion in such a way that the Secretary and staff of ECGD are still allowed to give their full attention throughout the period to maintaining, and continuing to improve, the Department's existing services to the exporting community. It would be unfortunate if the Department's attention was unduly diverted from these purposes during the run-up to a period of freer competition.

87. It is not our purpose to set out in detail a programme for effecting the change, but we see it as dividing into two main separate periods; the first between the policy decision to make the change and the necessary act reaching the Statute Book, and the second between then and the vesting date. We recommend that as soon as the initial decision has been made, either the role of the Export Guarantees Advisory Council should be modified, or the Chairman-designate of the corporation should be nominated, as well as perhaps one or two intended members of the board. Then a small team, with support from the absolute minimum number of officials segregated from ECGD's current tasks, can begin to plan for the change, consulting as necessary on detail of the intended legislation. In this first period the team would need to concern itself with such matters as board/top management structure, financial objectives and basis of taxation. At the second stage, once the legislation is passed, the full board should be appointed without delay, and then consideration given to the method of implementing the change, including the possibility of recruiting consultancy services or other specialist outside help.

IX SUMMARY

The Present Situation

88. To summarise, the evidence showed that:-

A. The services ECGD provides are widely used and appreciated by the United Kingdom's exporting community, although there were criticisms;

B. The quality of credit insurance and financing facilities in general compared favourably with those available to competitors in other countries, although greater flexibility and co-operation with the private sector should be encouraged;

C. A number of factors associated with the Department's status and activities as a government department hinder its efficient operation;

D. There is a widespread feeling that some change in the way the Department operates is now desirable, provided that the change does not disrupt its on-going activities;

E. At present it is not practicable to devolve ECGD's activities to the private sector, in whole or in part.

Principal Recommendations

89. We recommend that:

A. ECGD is replaced by a government-owned corporation, suitably capitalised, which should retain close links to the centre of government. Its activities should embrace all those now being carried on by ECGD (paragraphs 60-63, and 66).

B. The corporation's guarantees should have, and be seen to have, the full backing of Her Majesty's Government (paragraph 60).

C. The purposes of the corporation should be to provide insurance and financial services in support of exports, and to do so at a profit (paragraph 64).

D. The corporation should have a board of directors, with statutory responsibilities, replacing the present Advisory Council arrangements (paragraph 65).

E. The corporation should invest its reserves as determined by its board (paragraph 68).

F. The corporation should be enabled to raise funds in its own right for on-lending in certain situations (paragraphs 37,74).

G. The corporation should be enabled to reinsure risks with Her Majesty's Government or with private sector insurers (paragraph 70).

H. Its management should discriminate more between one risk and another than the Department now does (paragraph 72).

J. The corporation should be paid for administering schemes on behalf of Her Majesty's Government which are outside its normal credit insurance or financing functions (paragraphs 31,73).

90. The new corporation would have greater freedom in its management and operations than ECGD believes it has at present. It should use this freedom, and the flexibility it will allow, to develop both co-operation and competition with the private sector insurance market (paragraphs 25,75).

91. A number of organisational and operational matters should be tackled by management once the question of status has been resolved (paragraphs 76 - 85).

We are at your disposal to discuss any aspects of this report.

Sir Peter Matthews, AO.

K M Bevins. CBE, TD

P E Leslie.

19th March 1984

APPENDIX A

LIST OF BODIES WHICH PROVIDED EVIDENCE

The following provided evidence to the Committee:

Accepting Houses Committee, Export Finance Sub Committee
American Banks Association of London
American International Underwriters (UK) Ltd
Anzon Ltd
The Association of British Chambers of Commerce - members:

London Chamber of Commerce and Industry,
Luton, Bedford and District Chamber of Commerce and Industry,
The Medway and Gillingham Chamber of Commerce Incorporated,
Merseyside Chamber of Commerce and Industry,
Northamptonshire Chamber of Commerce and Industry.

Association of First Division Civil Servants, ECGD Branch
The Association of the British Pharmaceutical Industry
Babcock International plc
Balfour Beatty Ltd
Bank of England
Banque Francaise du Commerce Exterieur
Birmingham Chamber of Industry and Commerce, and the following individual members:

Blue Bird Confectionery Ltd
Brockhouse Export Ltd
Burnett & Company (Hull) Ltd
Fenchurch Credit Insurance Services Ltd
Halewood Chemicals Ltd
Titanium International Ltd
Tornado Model Products Ltd

British Aerospace plc

The British Constructional Steelwork Association Ltd

British Consultants Bureau

British Chemical Engineering Contractors Association

BEAMA Limited, Federation of British Electrotechnical and Allied Manufacturers Association

British Export Houses Association

British Export Houses Association, Export Finance Houses Sub-Committee, and the following individual members:

Barclays Export Services Ltd

Charterhouse Japhet Export Finance Ltd

Grindlay Brandts Export Finance Ltd

Midland International Trade Services (UK) Ltd

British Insurance Association

The British Insurance Brokers Association; The UK Credit Insurance Brokers Committee

British National Insurance Company Limited

British Overseas & Commonwealth Banks Association

British Overseas Trade Board (jointly with the Overseas Projects Board)

British Overseas Trade Board: East European Trade Council

British Overseas Trade Board: Latin American Trade Advisory Group

British Overseas Trade Board: Tropical Africa Advisory Group

British Overseas Trade Board: West Indies Trade Advisory Group

British Steel Corporation

C B Brook & Co Ltd

Dr P J Buckley, University of Bradford

Chemical Industries Association Ltd

Clarkson Puckle Overseas Ltd

The Cocoa, Chocolate and Confectionery Alliance/The Cake and Biscuit Alliance

The Committee of London Clearing Bankers

The Committee of Scottish Clearing Bankers

Confederation of British Industry

Coopers (Metals) Ltd

K W Cotterill, Esq, CMG
The Credit Insurance Association Ltd
Department of Trade and Industry
Doulton Insulators Limited
Engineering Employers Federation
The Export Association of the Electrical Cable Making Industry
Export Credit Insurance (Comprehensive Guarantees) Group
Export Credits Guarantee Department
ECGD Whitley Council: Departmental Trades Union Side
Export Guarantees Advisory Council
Foreign and Commonwealth Office
The General Electric Company plc
Glasgow Chamber of Commerce
Hawker Siddeley International Ltd
Henry Ansbacher Export Finance Limited
Hoare Govett Ltd
N E Hook, Esq
Imperial Chemical Industries plc
The Institute of Export
John Mowlem and Company plc
Lloyd's
London Chamber of Commerce and Industry
Lyndale Wools Ltd
Manchester Chamber of Commerce and Industry
Massey-Ferguson Holdings Limited
The Mining Association of the United Kingdom
Ministry of Defence
G Modiano (Wool and Hair) Limited
Morgan Grenfell & Co Limited
National Economic Development Office
Overseas Development Administration
Overseas Projects Board (jointly with the BOTB)
Pegler Hattersley plc
Process Plant Association
Project Loan Monitoring Ltd
Robert M Douglas Holdings plc
Samuel Montagu & Co Limited

The Scottish Council Development and Industry

The Society of British Aerospace Companies, Ltd

K Taylor Esq CB, idc

Trade Indemnity plc

Trafalgar House Group

H M Treasury

Westland plc

Sir Malcolm Wilcox, CBE

Willis Faber & Dumas Limited

Wool Processors Limited

APPENDIX B

A COMPARISON OF THE EXPORT CREDIT INSURANCE FACILITIES PROVIDED BY ECGD AND OTHER MAJOR OVERSEAS CREDIT INSURERS

As part of the review of the quality of ECGD's facilities, we made a study of the services provided by other countries' credit insurers. The main features of our findings, as they relate to the activities of some of the major credit insurers, are detailed in the table. For this purpose the major credit insurers are regarded as being:-

Compagnie Francaise D'Assurance pour le Commerce Exterieur (France)

CoFACE is a nationalised company which undertakes some short term commercial risks for its own account but all political and major commercial risks are taken for the government account with CoFACE acting as agent.

Hermes Kreditversicherungs AG (Federal Republic of Germany)

Hermes is a private company in which the government has no share. It carries out credit insurance in the domestic field (defined as including EC markets) for its own account; in the export field Hermes acts solely as an agent of the government with both political and commercial risks being for the government account.

Export-Import Bank of the USA (USA)

As an independent agency of government, Eximbank operates essentially as a state bank concentrating on providing support (guarantees and/or part financing) for major projects. It also reinsures export credit (both commercial and political risks) for other business where applications have been processed by the Foreign Credit Insurance Association, a private company, who act in an agency capacity.

Export Insurance Division
International Trade Administration Bureau
Ministry of International Trade and Industry (Japan)

EID is a division of the Ministry of International Trade and Industry. Both political and commercial risks are normally covered for the account of the state.

Export Development Corporation (Canada)

EDC is a Crown Corporation whose entire capital is subscribed by the government. The operation is split into two functions: a corporation account following commercial disciplines and a government account which accepts certain business which the board of directors deems to be non-commercial.

Special Section for Export Credit Insurance (Italy)

SACE is a state institution operated by a board whose membership is composed of representatives of concerned ministries. It covers both political and commercial risks and all guarantees are backed by the state. SACE also reinsures part of the commercial/political export credit risks assumed by SIAC, a company owned by state-controlled enterprises.

GENERAL INFORMATION (YEAR END 1982)	ECGD	COFACE	HERMES	EXIMBANK	EID/MITI	EDC	SACE
Percentage of national exports insured	34	33	9.2[A]	8.5	36.5	4.3	16.4 (1981 figure)
Value of national exports insured (Sw Fr Mn)	78,539	65,205	32,922	10,031	103,723	7,637	21,331
Number of insurance policies held	17,047	25,758	47,359[A]	4,208	491,786 (one for each transaction)	1,238	8,763
Premium income (Sw Fr Mn)	849.2	683.8	615.4	57.2[B]	222.3	25.4[B]	281.7
Number of staff employed[C]	1,797	1,028	543	323	175	175	258
TYPES OF POLICY AND FACILITIES							
Specific Policies							
Possible for all transactions	NO	NO	YES	NO	YES	YES	YES
Restricted to certain transactions (eg Medium/Long-term credit contracts)	YES	YES	NO	YES	NO	NO	NO
Global/Comprehensive/Wholeturnover Policies							
Possible for all types of business	YES[D]	YES	NO	YES	NO	YES[E]	YES
Possible for one specified buyer	NO	NO	YES	YES	NO	YES[E]	NO
Guarantees to banks (Supplier Credit)	YES	NO	NO	YES	YES	YES	NO
Guarantees to banks (Buyer Credit)	YES	YES	YES	YES	YES	YES	YES
Exchange Risk Cover	NO[F]	YES	YES	NO[F]	YES	NO[F]	YES
Pre-Shipment Cover	YES	YES	YES	YES	YES	YES	YES
External Trade	YES	YES	YES	NO	YES	NO	NO
Performance Bonds (Unfair Calling)	YES	YES	YES	NO	YES	YES	YES
Investment Insurance	YES	YES	YES	NO[G]	YES	YES	YES
CONDITIONS OF COVER							
Is PartCover possible?							
for part of credit period	NO	NO	NO	NO	NO	NO	YES
for part of amounts outstanding	NO	NO	NO	NO	NO	NO	YES
Percentage of Cover							
Guarantees to Banks (Supplier Credit)	100	N/A	N/A	100[H] 85-95[J]	80	100	N/A[K]
Guarantees to Banks (Buyer Credit)	100	95	95	100	95	100	90[K]
Political Risks	90-95	80-90	90	100	95	90	90
Commercial Risks	90	80-85	85	90	80-90	90	90
Risks Covered - Political and Commercial	YES	YES[H]	YES	YES	YES	YES	NO
Can exporter select risks covered?	NO	YES[H]	NO	NO	YES	NO	YES
Premium Rates: Are there different rates for private and public buyers?	NO	YES	YES	YES	YES	NO	YES

FOOTNOTES: A - Inclusive of EC business: B - Excluding Interest Income: C - This figure does not account for the variation in functions and distribution of responsibilities in national arrangements: D - Except plant, projects etc: E - If exporter's only buyer: F - But available from private market: G - But available from the Overseas Private Investment Corporation (USA): H - Political Risks only: J - Commercial Risks: K - 100% for credits deriving from inter-governmental agreements.

APPENDIX C

PRIVATE SECTOR INSURANCE FOR THE EXPORTER OR OVERSEAS INVESTOR

1. The Committee received a number of comments from private sector insurers and brokers about the facilities available in the private market and how these differ from those provided by ECGD. In general, the private sector tended to stress the greater flexibility of its facilities to meet the customers' individual needs.

2. Although it is evident that there has been significant growth in private sector activity on this type of insurance, no reliable statistics are available as to the total extent of private sector business. There is significant use of reinsurance to spread risks. The following paragraphs describe some of the characteristics of the main types of insurance and reinsurance available in the commercial markets in the UK.

Commercial ("Buyer") Risks

3. Several credit insurers offer cover against overseas buyers becoming insolvent or defaulting on their payment obligations. Formerly this cover was given mainly by companies who also insured the customer's domestic trade, for example Trade Indemnity plc, but latterly some insurers, notably subsidiaries of United States companies, have specialised in export-related risks. These policies seldom cover political risks.

4. This type of insurance is restricted almost entirely to buyers in markets where the political risks are not considered significant, such as Western Europe, North America, Australasia. The recent increase in the share of total UK exports going to European Community countries has encouraged its growth. Most private sector insurance is of exports on short credit terms.

5. Cover is most often given on a wholeturnover basis, sometimes as an extension of the customer's "domestic" policy, although cover for individual transactions may be available at suitable premiums. Typical exclusions are business with public buyers, overseas subsidiaries of the exporter, or individuals. Most private sector insurers apply no restrictions on the cover they will give to exports of foreign origin. The percentage of any risk covered by private sector companies is generally lower than that by ECGD.

6. Cover against commercial risks is not available at Lloyds.

7. The recovery of overdue debts is also regarded as an important feature and some companies offer this as a separate service.

8. Private sector insurers generally give greater emphasis than does ECGD to assessment of the effectiveness of an exporter's own credit management, and less to judgment of the buyer. Sometimes cover is given on an "excess of loss" or "catastrophe" basis, with the customer bearing a substantial first loss himself. Some insurers have reciprocal reinsurance arrangements with counterparts overseas.

9. Some private sector companies insure customers whose exports are small. Where those customers also insure substantial domestic trade, the insurer may consider the business as a whole when charging premiums. Alternatively, he may increase his charges, or impose particular conditions to avoid taking on uneconomic business. ECGD's application of these techniques has been limited.

Political Risks

10. Much of the available cover against political risks is from specialist syndicates at Lloyds. Contracts are insured on an individual basis as a rule. Some cover is also available from companies. The risks covered are not those of

non-payment of debts; most often they are of contract frustration, or financial default by public sector buyers or, in the case of investments, of expropriation. The range of political risks covered is broadly similar to that by ECGD, although war risk cover is usually more restricted. The period of cover is restricted to 3, or occasionally 5 or even 7, years, though yearly rollover arrangements are common where the restriction is to 3 years.

11. Recently there have been signs of a company market developing for treaty-type insurance of political risks, sometimes combined with cover against insolvency of private buyers, though as yet this is not widely used in the United Kingdom.

12. There is also a market at Lloyds for reinsurance cover on an excess loss basis which is used, among others, by some of ECGD's counterparts abroad to limit their exposure on particular countries. Cover can also be obtained for individual contracts on occasion when the official credit insurer is off cover for a country.

13. Cover is available for new and existing investments overseas. The risks covered are again similar to ECGD's own policy, except that war risks to land-based assets are excluded and cover for restrictions on remittances is less extensive. However, separate insurance is available for loss arising from confiscation of overseas assets by government order. ECGD's cover is intended at present for new investments and is only available for existing investments where associated with a new injection of resources. Cover from the private market is available for up to 3 years at the outset (compared with up to 15 years from ECGD), but rollover arrangements are available.

14. Generally, the private sector's approach to political risks is governed by individual judgments on specific cases. It makes frequent use of a wide range of deductibles and premiums.

Other Insurance

15. There is also cover available for performance and other bonds; for barter trade contracts; for the period when ECGD's own cover is not yet unconditionally in place; against a buyer's refusal to honour an arbitration award; and for other contingent liabilities.

Brokers

16. Brokers are an important part of the private market and, where Lloyds is concerned, they are the sole access to cover. Brokerage rates vary, but ECGD, over half of whose comprehensive guarantee business is brokered, currently pays 5% of premiums on continuing business, or up to 20% for new business.

17. Credit insurance broking is a specialist section of the market, with its own sub-committee of the British Insurance Brokers Association. Its membership is quite wide but the business is largely concentrated within a few names, some of whom are active in Lloyds. They represent one of the main interfaces between the credit insurer and the exporter, with significant capacity to help growth of business.

TRADE i ECGD Jamto

FILE E(A) :- R M

HC: N.O.

HMT✓ DOE✓ MAFF✓
NIO✓ LPS✓ Chief Sec✓
D.Energy✓ D. Trans✓
SO✓ CDL✓ CO
WO✓ D.Emp✓

10 DOWNING STREET

From the Private Secretary

13 December, 1983

ECGD COST ESCALATION SCHEME

The Prime Minister has seen the Minister for Trade's letter of 6 December to the Chief Secretary. She is content that an announcement should be made of the winding up of the ECGD Cost Escalation Scheme.

I am sending a copy of this letter to the Private Secretaries to the Members of E(A) and to John Kerr (HM Treasury), Richard Mottram (Ministry of Defence), David Heyhoe (Lord Privy Seal's Office), Ivor Llewelyn (Ministry of Agriculture, Fisheries and Food) and to Richard Hatfield (Cabinet Office).

(A. Turnbull)

J. Rees, Esq.,
Department of Trade and Industry

CHIEF SECRETARY TO THE TREASURY



Treasury Chambers, Parliament Street, SW1P 3AG

Rt Hon Paul Channon MP
Minister of State for Trade
Department of Trade
1 Victoria Street
LONDON
SW1E 6RB

9 December 1983

Dear Minister

ECGD COST ESCALATION SCHEME

attached

Thank you for your letter of 6 December.

I am sure that it is right to make an early statement of our intentions and I am quite content with the terms of the draft Parliamentary Answer you have put forward. Similarly, I agree that we must honour our promise to give cost escalation cover in cases where applications are already lodged with ECGD and where the contract can be signed in time to allow the issue of a guarantee before 26 March 1984.

Finally, you suggest that when we next legislate for ECGD we should look again at the need for similar powers. Such an opportunity may arise quite quickly but you will understand from my earlier letter that I would see real objections to such a course. I therefore hope that those concerned in industry will be given no reason to expect such a step.

I am copying this letter to Members of E(A), Sir Geoffrey Howe, Michael Heseltine, John Biffen, Michael Biffen and Sir Robert Armstrong.

Yours sincerely

J.S. Grieve

for PETER REES

[Approved by the Chief Secretary]

12 DEC 1983



V395

F.

DEPARTMENT OF TRADE AND INDUSTRY
1-19 VICTORIA STREET
LONDON SW1H 0ET

Telephone (Direct dialling) 01-215)
GTN 215) .....
(Switchboard) 215 7877

From the Minister for Trade

Prime Minister (2)
DTI have accepted winding up of cost escalation scheme. AT 12/12

Rt Hon Peter Rees QC MP
Chief Secretary to the Treasury
HM Treasury
Parliament Street
London SW1

6 December 1983

Dear Peter.

I raised the question of the ECGD Cost Escalation Scheme in my letter of 2 November. In view of your reply of 8 November and the Prime Minister's views that the scheme has now outlived its usefulness, it seems right to let it lapse on the 26 March when the existing powers expire.

I am being urged by industry to make an early statement of our intentions, and I propose to do this in terms of the attached draft Parliamentary answer.

I do not foresee any problems over applications already lodged with ECGD: in only one case is there any likelihood that a contract could be signed in time to allow the issue of a guarantee before 26 March 1984, and we should of course have to honour our promise to do this if the exporter so wished but I think there is quite a likelihood that cover will not in the event be taken up.

As you know, the CBI, the Overseas Projects Board, and other representatives of the heavy end of industry, have urged very strongly that we should retain the powers to provide cost escalation cover, notwithstanding current inflation levels, as an assurance to companies contemplating bidding on major projects with long implementation periods that the cover could quickly be made available again should the need arise. Michael Heseltine's letter of 16 November also expressed the hope that the scheme might be re-introduced if economic conditions outside our control change. I do not think we need decide this now, but we may need to look at this again as circumstances change and when we next legislate for ECGD. I am copying this to members of E(A), Geoffrey Howe, Michael Heseltine, John Biffen, Michael Jopling and to Sir Robert Armstrong.

Yours,

Paul

PAUL CHANNON

DRAFT WRITTEN PARLIAMENTARY QUESTION AND ANSWER

ECGD COST ESCALATION SCHEME: RENEWAL OF STATUTORY POWER

QUESTION: To ask the Secretary of State for Trade and Industry if, in view of the current level of inflation, the powers under which the Export Credits Guarantee Department operates the cost escalation scheme, are to be renewed.

ANSWER: As a result of the Government's continued success in bringing inflation under control, very few applications have been made to ECGD for cost escalation cover in recent years. I appreciate that this scheme has in the past provided industry with considerable and valuable assistance in securing a number of major export contracts but I believe that it is no longer necessary in the current economic climate. I do not, therefore, intend to seek a further extension of the powers, and no further applications for this form of cover will be accepted. ECGD's existing commitments under cost escalation agreements already issued will, of course, remain unaffected.

CONFIDENTIAL

NBPM AT 7/12

Foreign and Commonwealth Office

London SW1A 2AH

From The Minister of State

The Rt Hon Peter Rees QC MP
Chief Secretary to the Treasury
HM Treasury
Parliament Street
London W1

6 December 1983

Dear Peter,

COST ESCALATION SCHEME

1. I refer to Paul Channon's letter of 2 November to you about the renewal of this Scheme.

2. In his letter of 5 January, Douglas Hurd supported the Scheme's renewal for 1983/84, but made the point that it has faced international criticism. I see that the UK has now told the EC Commission that if agreement is obtained for an extension of the Scheme beyond 26 March 1984, the benefit of the Scheme will be made available on equal terms to sub-contracts with companies in other EC Member States. This commitment is likely to increase the complexity and potential cost of operating the Scheme, with no additional benefit to UK exports.

3. A decision to end our Scheme would be welcomed by most of our EC and Consensus partners; therefore, in view of the current low level of inflation and the corresponding lack of demand for cover, I believe that ECGD's powers to provide Cost Escalation Cover should be allowed to lapse when they expire next March.

4. I am copying this to the recipients of Paul Channon's letter.

Yours ever,

Malcolm Rifkind

CONFIDENTIAL

Trade ECGD Jan 80



NBPM
BT 17/11

MINISTRY OF DEFENCE WHITEHALL LONDON SW1A 2HB

TELEPHONE 01-218 9000
DIRECT DIALLING 01-218 2111/3

MO 32/3

16th November 1983

Dear Paul

COST ESCALATION SCHEME

Thank you for sending me a copy of your letter of 2nd November to the Chief Secretary about the renewal of this scheme. I have since seen his response, and also the Prime Minister's comments.

As I said when this matter was last considered in January this year, very little use has been made of the scheme to support defence sales. Moreover, our continued success in restraining inflation removes the need for the scheme in the immediate future and should give industry the confidence it requires to bid for long term contracts. It therefore seems more difficult to justify retention of the scheme at the present time, and I would be content to see it lapse. However, I would hope that it could be reintroduced without undue difficulty if economic conditions outside our control, such as another major oil crisis, made this necessary to safeguard both civil and defence exporters from a dramatic increase in inflation.

Copies of this letter go to the recipients of yours.

Yours ever

Michael Heseltine

The Rt Hon Paul Channon MP

Trade
Jun '80
Cost Escalation.

17 NOV 1983

From: THE PRIVATE SECRETARY

NORTHERN IRELAND OFFICE
WHITEHALL
LONDON SW1A 2AZ

NBDM NT 14/11

Callum McCarthy Esq
PS/The Rt Hon Paul Channon MP
Department of Trade and Industry
1-19 Victoria Street
London SW1H OET

14 November 1983

Dear Mr McCarthy

COST ESCALATION SCHEME

Mr Prior has seen Mr Channon's letter of 2 November to Mr Rees. He fully agrees with the course Mr Channon proposes. While there has not been a high take up of this particular form of guarantee in Northern Ireland it is of great benefit to exporters seeking major overseas contracts.

I am copying this letter to the Private Secretaries to the Chairman and Members of E(A) to Brian Fell (FCO), Richard Mottram (MOD), David Heyhoe (Lord Privy Seal's Office), Robert Lowson (MAFF) and Richard Hatfield (Cabinet Office).

Yours Sincerely

for D A HILL

CAM

TRADE: Cost escalation cover scheme: Jo 80



14 NOV 1983

Prime Minister (2) c. NO.

I have minuted out recording that you too take view at X.

AT 9/11

CHIEF SECRETARY TO THE TREASURY

Treasury Chambers, Parliament Street, SW1P 3AG

The Rt Hon Paul Channon MP
Department of Trade and Industry
1 Victoria Street
LONDON
SW1H OET

8 November 1983

Dear Minister

COST ESCALATION SCHEME

Thank you for your letter of 2 November in which you proposed to extend the cost escalation cover scheme for a further year, with a view to putting it on a permanent basis as suggested by the CBI, at the next legislative opportunity.

I see considerable objections to a permanent scheme of this kind. It was explicitly introduced as a temporary facility and has so been defended on each extension. It is unlikely to be in the long term interest of the UK economy to provide a scheme incorporating subsidies which protects a particular export sector from market forces. Moreover extension on a permanent basis would be likely to revive international hostility which the recent infraction proceedings threatened by the Commission show is only just below the surface.

X When I announced the temporary extension of the scheme last year, I expressed the hope that our success in reducing inflation would lead to a position in which the scheme could be allowed to lapse. In my view that time has now come. Our policies have successfully reduced inflation below the level at which the scheme is operative. Equally important, they have succeeded in reducing contractors' expectation so that applications for cover have virtually ceased. Continuation of the scheme would be entirely inconsistent with our objective of price stability. Withdrawal in these circumstances would be unlikely to inhibit contractors in bidding for overseas contracts.

Moreover, the benefits from the scheme are confined to a limited sector of the capital goods industry - the same sector who already benefit from interest support subsidies. It is difficult to defend a privileged position for this sector of the economy and its protection from market forces. Other sectors have to take equally long term decisions without the benefit of a Government provided hedge against inflation.

I accept that the scheme at present costs nothing and that any premium on new guarantees would serve to reduce - marginally - the substantial net cost to the Exchequer incurred so far. But that is not a strong argument for continuing - or making permanent - a scheme which was expected to make losses and, being open-ended, could impose significant further costs in the future. Any suggestion that the scheme should be put on a permanent basis seems likely to give rise to pressures to make it more generous. We have also agreed to make any extended scheme available to sub-contractors in other EC countries. We do not expect this to give rise to costs in the short term but it effectively puts the UK Exchequer at risk in relation to other countries' future inflation.

For all these reasons, I believe it would be wrong to renew the Scheme.

I am copying my letter to the recipients of yours.

Yours sincerely

Jock Grieve

PETER REES

[Approved by the Chief Secretary]

TRADE:
ECGD, Jan 80.

-9 NOV 1983



CONFIDENTIAL

FILE

B/c: Mr Owen

10 DOWNING STREET

From the Private Secretary

7 November, 1983

COST ESCALATION SCHEME

The Prime Minister has seen your Minister's letter to the Chief Secretary of 2 November recommending continuation of the Cost Escalation Scheme for a further year with a view to making the powers permanent in the next substantive ECGD Bill. The Prime Minister feels that this scheme has served its purpose but that the time is now right to wind it up.

I am sending a copy of this letter to the Private Secretaries to the Members of E(A), and to Brian Fall (Foreign and Commonwealth Office), Richard Mottram (Ministry of Defence), David Heyhoe (Lord Privy Seal's Office), Robert Lowson (Ministry of Agriculture, Fisheries and Food) and Richard Hatfield (Cabinet Office).

(A. Turnbull)

J. Rees, Esq.,
Department of Trade and Industry

CONFIDENTIAL

CONFIDENTIAL

4 November 1983

MR TURNBULL

Prime Minister

Agree scheme should be ended?

cc Mr Mount

COST ESCALATION SCHEME

This scheme should be terminated. AT 4/11

In 1980, the then Minister for Trade argued for an extension of this scheme of one year "on a clear understanding that no further extension will be made once that year has expired". He argued that the scheme could not be abandoned at that time, when it was most needed (the Pound was high, so was inflation) but that an indefinite extension of the scheme could not be contemplated because it was "fundamental to our strategy that firms should not be protected against the consequences of their own cost increases". Three years later, inflation is under control, the scheme is hardly used and would scarcely be missed. What better opportunity could there possibly be to wind up a subsidy? Yet Mr Channon is arguing that the scheme should be retained because it costs us nothing, and be made permanent in the next substantive ECGD Bill. We have, then, a set of arguments for perpetual subsidy: if a subsidy scheme is relied upon heavily, we cannot abandon industry in its hour of need; if it is not used, it costs us nothing.

If inflation rises in the future, GEC and others will certainly exploit the scheme because it allows them to play it to their advantage. But do they need it? The paper implies that the capital goods industry has special needs. This argument is based on a misunderstanding. First, any industry which is exposed to international competition is vulnerable to cost escalation, whether or not this escalation is foreseen, and whether or not contracts involve fixed prices.

Second, the capital goods industry, which accounts for perhaps 1 per cent of GDP, already receives favoured treatment. A study by Treasury economists last year indicated that, on average, capital projects receive subsidies in the form of interest rate credit and ATP, equivalent to 30-70 per cent of the UK content. The Castle Peak power station, for example, received a subsidy of 42 per cent; the Sicartsa project received a subsidy of 65 per cent - considerably higher than the Polish ship contract (subsidy of 34 per cent). It is understandable that lumpy and visible export contracts should attract particular attention - they are reported in the media, whereas routine sales of, say, overcoats

CONFIDENTIAL

are not - but there is no economic justification for subsidising them. We would be better off if we concentrated instead on winning business which yielded the country a better return.

Mr Channon's note mentions the international criticism which this scheme has attracted. With France - a notorious subsidiser - we are alone in providing this kind of cover, a fact which is bound to continue to be resented, and criticised. Why incur this criticism for so little commercial advantage?

The scheme is also a poor advertisement for the Government's economic policies. We have always argued that industry would be one of the main beneficiaries of sound economic policies, which stabilise the value for money and enable planning to be conducted with greater confidence. Why, then, maintain an insurance arrangement which caters for situations in which these policies will either change or go wrong? This is surely an opportunity to wind up a subsidy, which imposes contingent risks on the Exchequer, citing, as the explanation, the benefits of sound economic management. We recommend that no further extension be granted.

NICHOLAS OWEN

Trade : ECGD Jan'80

V892

BF with Treasury response AT 3/11

LECNO

DEPARTMENT OF TRADE AND INDUSTRY
1-19 VICTORIA STREET
LONDON SW1H 0ET
TELEPHONE DIRECT LINE 01-215 5144
SWITCHBOARD 01-215 7877

From the Minister for Trade

Rt Hon Peter Rees QC MP
Chief Secretary to the Treasury
HM Treasury
Parliament Street
London SW1

2 November 1983

Dear Peter.

COST ESCALATION SCHEME

A year ago you were involved in the considerations leading up to the annual renewal of this Scheme and it now falls to me to clear the Government's position on renewal.

A full review of the financial position and prospects of the scheme have been circulated at official level, and the various policy options examined. In practice the only options available to us without new legislation are to let the powers lapse or renew them by statutory order for a further period of 12 months.

Earlier this year the CBI wrote to the Secretary of State on behalf of British industry urging that the Scheme should be kept in being and that it should also be made permanent. This latter action would need a change in legislation, and I would propose to note this request sympathetically for action when ECGD need new powers, which is likely to be in the year 1984/85.

The CBI pointed out that given the substantial sums involved, the submission of bids on fixed-price contracts, desired by many buyers, depends on reasonable certainty that unforeseen increases in future UK costs will not undermine a contract's profitability and jeopardise the jobs which depend on it. Not only this, but UK exporters are in some cases also having to accept buyers' conditions that on non fixed-price contracts only a small addition will be permitted for cost increases over the contract life, which be as long as five or six years. As exporters start looking at projects with construction periods stretching into the early 1990s, industry needs to have the necessary reassurance to encourage them in this field. Past experience has shown that it is the number of bids submitted backed by the Scheme, rather than the number of policies actually issued, which give the best index of the value

of the facility. Although guarantees already given will probably produce a loss to the Exchequer of about £85M (which there is no realistic hope of recovering), on current Treasury estimates of inflation there will be no cost to the Government in allowing this Scheme to continue apart from the cost of 5 staff administering existing guarantees. Although very few applications are currently being received, premium earned on new cases would serve to reduce the cost to the Government of the Scheme so far; we also understand that cover is likely to be wanted for the Guangdong Power Station in China, if this project materializes.

It seems to me that if we can keep a Scheme going which costs us nothing and which may help to make the heavy end of British industry more willing to bid for large overseas contracts, then it is to the advantage of the UK economy as a whole to do so. Although Cost Escalation Cover has in the past attracted strong criticism in GATT and other international fora as an unacceptable form of export subsidy, there has been little active discussion of the subject for the past 3 years or so. My conclusion is therefore that our preferred course should be to renew the Scheme on its present basis for a further year, with a view to making the powers permanent in the next substantive ECGD bill.

If you and other colleagues to whom I am copying agree, I should like to make an early announcement of our intention to seek Parliamentary approval for a renewal of the existing powers for one year from 26 March 1984.

I am copying this to members of E(A), Geoffrey Howe, Michael Heseltine, John Biffen, Michael Jopling and to Sir Robert Armstrong.

PAUL CHANNON

Trade Jan 80

ECGD



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

NBPM
MH 22/9

From the Minister

CONFIDENTIAL

The Rt Hon Paul Channon MP
Minister for Trade
Department of Trade and Industry
1 Victoria Street
London SW1H OET

29 July 1983

Dear Paul

REVIEW OF ECGD'S STATUS

Thank you for sending me a copy of your minute of 22 July to the Prime Minister.

I have no points to make on the proposal to hold a review or on the proposed members of the Committee.

Food and agricultural exports have increased in recent years and there have been criticisms from exporters of some of these products that ECGD has not been ready to go far enough to match the terms available to their overseas competitors. I regard this as an extremely important consideration and I am glad to see that it is given prominence in the suggested terms of reference.

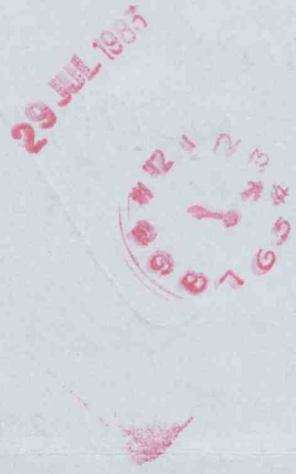
I also hope it can be accepted that the Committee will invite evidence from the trade associations which represent the exporters of food and agricultural products as well as those representing industrial exporters.

I am copying this letter to the Prime Minister and other members of E(A), Geoffrey Howe, Michael Heseltine and Sir Robert Armstrong.

Yours

Michael

MICHAEL JOPLING


29 JUL 1985

CONFIDENTIAL

[redacted]

10 DOWNING STREET

From the Private Secretary

29 July 1983

Dear Jonathan,

Review of ECGD's Status

The Prime Minister has seen your Secretary of State's minute of 22 July, and your letter to me of 26 July, about the proposed review of the organisation and functions of the Export Credits Guarantee Department.

The Prime Minister agrees to the setting up of this review, as proposed.

I am sending copies of this letter to the Private Secretaries to the members of E(A), Brian Fall (Foreign and Commonwealth Office), Richard Mottram (Ministry of Defence) and Richard Hatfield (Cabinet Office).

Yours sincerely,

Michael Scholar

Jonathan Rees, Esq.,
Office of the Minister for Trade.

CONFIDENTIAL

V316

CONFIDENTIAL

Prime Minister (2)

I'm asked why the terms of reference of the ECGD Review were so wide.

MCS 26/7

From the
Minister for Trade

DEPARTMENT OF TRADE
1 VICTORIA STREET
LONDON SW1H 0ET

TELEPHONE DIRECT LINE 01 215 5144
SWITCHBOARD 01 215 7877

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

26th July 1983

Dear Michael,

REVIEW OF ECGD's STATUS

My Minister minuted the Prime Minister on July 22 with MCS? suggesting that we set up an independent enquiry to review ECGD's status. You told me yesterday that the Prime Minister had asked whether the proposed terms of reference were not too wide, and for some explanation of the thinking that lay behind them.

The terms of reference are drafted to cover two main points. First, could ECGD do its job better if its status were changed (eg into a public corporation)? Although two post-war enquiries have on balance favoured retention of Departmental status, ECGD's functions have expanded considerably since the last review in 1972 and the balance may have altered. Secondly, is there now scope for privatising some of the functions, currently carried out by ECGD - eg the possibility for further collaboration with the small but slowly growing private insurance sector? To answer both these questions, Mr Channon believes the terms of reference should enable the Committee to consider not only ECGD's present structure and status, but also the functions which the Department should or should not be expected to continue to perform. However we would intend that the Committee would only look at functions in broad terms, and not go into the details of each of ECGD's facilities, which have as Mr Channon noted, been considered on several occasions in the last couple of years, most recently by the CBI. The references to the taxpayers' interests and to the quality of service to UK exporters were included after discussion with the Treasury, and are designed to establish the general background against which the Committee should work, and in particular to guard against any recommendations favouring greater subsidies for exports.

Finally, I should perhaps add that Mr Rees, when Minister for Trade, discussed in general terms with Sir Peter Matthews, the sort of enquiry which we intended and

CONFIDENTIAL

the proposed terms of reference. Should the Prime Minister agree to this review being launched, Mr Channon would in turn intend to keep in close touch with Sir Peter Matthews to ensure that the review does not range too widely.

I am copying this letter to the Private Secretaries to members of E(A), the Foreign Secretary, the Secretary of State for Defence and Sir Robert Armstrong.

Yours Sincerely,

Jonathan Rees

JONATHAN REES
Private Secretary to the
Minister for Trade (PAUL CHANNON)



010

V202

NO

Yes - but terms of reference are still very wide

Prime Minister (1)

Agree* this Review, as proposed?

MCS 22/7

CONFIDENTIAL

PRIME MINISTER

* subject to colleagues

REVIEW OF ECGD's STATUS

1 This minute is to seek your agreement to the establishment of a small independent committee to review the organisation and functions of the Export Credits Guarantee Department. You may recall that Arthur Cockfield's letter of 1 November 1982 to Geoffrey Howe on the privatisation exercise included this proposal.

2 The case for a review of ECGD's status is strong. ECGD's status as a Government Department is unusual. Its operations are predominantly commercial, and in fulfilling its remit of encouraging trade, it insured over £19 billion of UK exports in 1982 alone. Its status has not been reviewed since 1972, since when the scope and scale of its operations has increased dramatically. The CBI, in a recent report on ECGD, recommended that its status be reviewed, and the Chairmen of the Export Credit Advisory Council, the British Overseas Trade Board, and the Overseas Projects Board agree. The scope for greater private sector input in this area also fits in well with our general policy on privatisation. For all these reasons, both Cecil Parkinson and I think the case for a review is timely. However, let me emphasize that we should not pre-judge its outcome. ECGD has weathered the current international debt crisis (Poland, Iran, Latin America etc) remarkably well to date and has continued to operate at no net cost to public funds while supporting increasing amounts of exports in risky markets. It has performed much better than most of the export credit agencies in other major countries

3 Treasury Ministers agree that the form of enquiry which will best command public confidence would be a small independent committee of outsiders. I propose that the Chairman should be Sir Peter Matthews, Chairman of Vickers and of course a prominent exporter. He would be supported by representatives of the banking and the private insurance sector. The two names I have in mind are Mr P E Leslie, Director and General Manager of Barclays Bank International, and Mr K N Bevins, Director of the Royal Insurance Company, and former (1975-80) part-time Chairman of Trade Indemnity Company which is ECGD's largest private sector "competitor". I attach the relevant c.vs. Nigel Lawson is happy with these names.

CONFIDENTIAL

4 The terms of reference for the Committee should concentrate fairly narrowly on the question of ECGD's status rather than review once more the more general issues of ECGD's services. This has been done on several occasions in the last couple of years, notably by the statutory Export Guarantees Advisory Council under Malcolm Wilcox in 1981. I therefore suggest that the terms of reference should be as proposed in the annex to this minute.

5 On timing, subject to your views and those of colleagues to whom I am copying this minute, I hope that we could be in a position to launch the review before the Summer Recess. The Committee could then invite evidence from the main industrial banking and insurance Associations directly concerned, as well as taking evidence from Departments at official level. I would then hope that the Committee might be in a position to complete its report within about 6 months - I understand that Sir Peter Matthews thinks this timescale feasible. I would intend that the main recommendations of the Committee's report then be published, although we may prefer not to publish the report in full.

6 I should therefore be grateful for your agreement to launch this Review.

7 I am copying this minute to the Chancellor and to Sir Robert Armstrong, who have both been consulted earlier on this proposal, and also to members of E(A), to Geoffrey Howe and Michael Heseltine.

P.C

PAUL CHANNON
22 July 1983

They are very wide - is that the intention?

ANNEX A

REIVEW OF ECGD'S STATUS

Proposed Terms of Reference

To review ECGD's structure and functions, and its present status as a Government Department, taking into account in particular:-

(i) the importance to UK exporters of the quality of the credit insurance and financing facilities provided by ECGD, compared with those available to their competitors;

(ii) the taxpayers' interest in containing the actual and potential costs of ECGD's operations;

(iii) the possibility of devolving any functions to the private sector or collaborating with the private sector in carrying them out.

KENNETH MILTON BEVINS, CBE, TD

Director, Royal Insurance Company Limited since 1970
British Aerospace, plc since 1981

Born: 2 November 1918

Secretary, Royal Insurance Company Limited, 1957
General Manager, 1963, Deputy Chief General Manager, 1966,
Chief General Manager, 1970-80

Director, Trade Indemnity Company Limited, 1970-80
(Chairman, 1975-80)

Mutual and Federal insurance Company Limited, 1971-80

Director, Fire Protection Association, 1963-77

Member, Joint Fire Research Organisation Steering Committee, 1966-68

Home Secretary's Standing Committee on Crime Prevention, 1967-73

Executive Committee, City Communications Centre, 1976-80

Board, British Aerospace, 1980-81

Chairman, British Insurance Association, 1971-73
(Deputy Chairman, 1967-71).

Age: 64

SIR PETER ALEC MATTHEWS, AO

Chairman, Vickers Limited since 1980
(Managing Director, 1970-79)

Pegler-Hattersley Limited, since 1979
(Director since 1977)

Director, Lloyds Bank since 1974
(Chairman, Central London Regional Board, 1978)

British Electric Traction Company Limited since 1976

Sun Alliance and London Insurance since 1979

Lead Industries Group since 1980

Born: 21 September 1922

Joined Stewarts & Lloyds Limited, 1946

Director of Research and Technical Development, 1962

Member, for Research and Development, BSC, 1968-70
(Deputy Chairman, 1973-76)

Member, British Overseas Trade Board, 1973-78

Export Guarantees Advisory Council, 1973-78

NRDC, 1974-80

Engineering Industries Council, 1976-
(Chairman, 1980)

continued 2

Advisory Council for Applied Research and Development, 1976-80

Senior Deputy President, Engineering Employers' Federation, 1981

Chairman, Council, University College, London, 1980-

CBIM, FRSA

Age: 60

Prime Minister

I know Mr Leslie. He is an able man. He would have to give up a lot of his Bank work for 6 months to do this effectively.

MCS 22/7

PETER EVELYN LESLIE

Director, Barclays Bank plc

Director and Senior General Manager, Barclays Bank International Ltd

Director, Barclays International Holdings Ltd

Director, Eagle Leasing Ltd

Joined Barclays Bank DCO in 1955; served in the Sudan, East Africa, Israel, Algeria, Zaire, Kenya, the Bahamas.

Returned to the UK in 1971 as Assistant General Manager in Barclays Bank International Ltd. Became General Manager in charge of planning and marketing for Barclays Bank International and Barclays Bank Ltd in 1973.

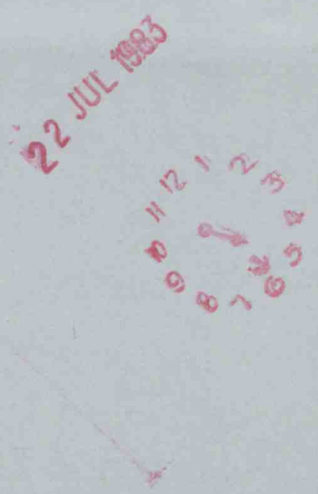
Became General Manager of Barclays Group Finance in 1973. Became General Manager of Barclays Bank International in charge of European operations in 1977.

Member, City Capital Markets Committee, 1974-77.
Appointed to Executive Committee of the British Bankers' Association, 1973 (Chairman 1978-79).

Member, Export Guarantees Advisory Council, 1978-81.

Date of Birth: 24 March 1931

Age: 52.


22 JUL 1983

DEPARTMENT OF TRADE 1 VICTORIA STREET LONDON SW1H 0ET Telephone 01-215 7877

From the Secretary of State

cc PS/All Ministers
PS/Secretary
PS/Secretary, ECGD
Mr Gray
Mr Caines
Mr P A P Brown
Mr Knighton
Miss Lackey, WEG
Mr Blanks, CAP
Mr Bryne, MAR
Mr Eagers, CS
Mr Reid, C
Mr Davis, Pats
Mr Burbridge, OT 3
Mr Mason, WEG
Mr Berry, WEG (with papers

CONFIDENTIAL

The Rt Hon Sir Geoffrey Howe QC MP
Chancellor of the Exchequer
HM Treasury
Treasury Chambers
Parliament Street
London
SW1P 3AG

(November 1982

PRIVATISATION

My colleagues and I have carried out a thorough review of my Department's activities to see what can be transferred to the private sector. I have also reviewed the possibility of abandoning some activities altogether.

I see scope for substantial advance in three areas: British Airways; airports; and export credit insurance.

We have already agreed to privatise British Airways and announced our decision. Enabling legislation - the Civil Aviation Act 1980 - has been passed; I shall shortly put proposals to E(NI) on the necessary capital restructuring, which would require a short Bill; we shall then have to take decisions on the timing of flotation.

On airports, our objective is clear: to minimise Government involvement in their ownership and operation.

I aim to dispose of some or all of the Civil Aviation Authority's aerodromes in the Highlands and Islands of Scotland (with a continuing Scottish Office grant) to the airlines who use them. One or two disposals of this kind may be possible before the Election.

CONFIDENTIAL

From the Secretary of State

We have agreed that we cannot privatise the British Airports Authority's airports in the short-term because of the uncertainties arising from the current litigation by airlines and, to a lesser extent, the public inquiries into the expansion of the South East airports. But we are actively investigating the scope for introducing private sector finance into the Authority's investment programme, starting in this Parliament.

The Authority's airports are, however, clear candidates for privatisation in the next Parliament. This will raise a series of problems, which we have already started to work our way through. We are also looking at the future ownership of local authority airports in connection with Michael Heseltine's exercise on the metropolitan authorities, and considering whether local government should be in the airport business at all.

ECGD provides, in the field of export credits, an insurance and financing service. Although the latter is now largely privatised in the sense of the banks serving exporters with all the funds needed (other than interest rate subsidy) under simple ECGD guarantees, the private sector has developed very little in the way of competitive or supplementary export insurance facilities. Governments cannot escape involvement in the political risks of such insurance; but there should be scope for devolving some of ECGD's operations on the United Kingdom private sector. Also, in contrast to independent enquiries in the mid-50s and early-70s, an E & AD Departmental "efficiency audit" favours ECGD changing from Departmental to public corporation status. These findings are due to come before the PAC shortly. A recently-published CBI report has made similar recommendations.

We shall therefore be undertaking a fundamental review of ECGD's future organisation and functions, which will cover the scope for privatisation. But if substantive changes appeared possible legislation would be needed and implementation would then have to be left to the next Parliament.

From the Secretary of State

In addition to these three major areas, our review has identified several other functions which might be discontinued or substantially devolved to the private sector. Individually they are minor - even very minor - variants on the privatisation theme, whether judged in terms of staff or of expenditure, but collectively they offer promise of a useful slimming down of the scope of the Department's activities. The areas where I am looking for progress, in most cases starting in this Parliament, are:-

- discontinuing film industry controls as rapidly as political considerations allow;

- further reducing our involvement in seamen's conditions of service;

- further devolvement of ship surveys and marine equipment approval to classification societies;

- further devolvement of the actual setting and conduct of seafarers' examinations;

- devolving from the Companies Registration Office the issue of copies of company documents after they have been registered;

- devolving from the Patent Office the publication and distribution of patent specifications;

- devolving to private sector bodies (eg Chambers of Commerce) the administration of the British Overseas Trade Board's Outward Mission Scheme, which organises overseas visits for groups of businessmen to seek export opportunities: and

From the Secretary of State

CONFIDENTIAL

- an expansion of the revenue earning activities of the Simplification of Trade Procedures Board (SITPRO) leading, perhaps three years hence, to its conversion to a private sector body operating on an essentially commercial basis.

I would take this opportunity to mention one other possible candidate for privatisation, namely the Meteorological Office. This falls within John Nott's responsibility but the industries for which I am responsible pay a substantial part of the cost. The industry's principal representative body, the British Civil Aviation Standing Conference (BCASC), has suggested that some or all of the Met Office's activities could be transferred to the private sector. BCASC believe that market pressures would increase the Met Office's cost-effectiveness and accountability to its customers. I have written to John Nott expressing the hope that as the Minister responsible he will take the same view.

I am sending a copy of this letter to the Prime Minister, to the other members of E(DL), to John Nott and George Younger, and to Sir Robert Armstrong.

LORD COCKFIELD

CONFIDENTIAL

SECRET 2

TRADE

Prime Minister (2)

You asked about this.

MLS 8/11

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

8 November 1982

Michael Scholar, Esq.,
No.10 Downing Street

Dear Michael,

ONCE-OFF PAYMENT TO ECGD

You asked in your letter of 25 October for a note on the possibility of a once-off payment to ECGD in 1982/83 which was raised at the Prime Minister's discussion with the Chancellor on that day about the 1982/83 PSBR undershoot. Unfortunately such a payment would not in itself help the undershoot. ECGD banks with the Consolidated Fund like any other Government Department, so a once-off payment would just be a transfer from one pocket of central government to another with no PSBR effects.

To affect the undershoot ECGD would have to spend money (i.e. cause its financial position to deteriorate) in 1982/83. But no premium increase which could be reduced or delayed is contemplated during the rest of this financial year, and, because of normal time-lags, a premium reduction would have little effect this year. Perversely, it would have a much bigger effect in 1983/84.

The Chancellor agrees with the Prime Minister that it would be a matter of concern if ECGD were charging high premia in relation to those charged by other official credit insurance agencies. This is a matter which ECGD and the Treasury considered during the last premium review which resulted in the premium increases effective from July 1982. Precise comparisons are difficult because of differences in national arrangements and facilities, but broadly we believe ECGD's premia are in line with most of their competitors. The latest comparative figures we have are for 1981 and they are enclosed. They showed ECGD rates as below both mean and average at every point. There has been one ECGD increase averaging about 10 per cent since then, but other countries' rates have increased also.

Yours sincerely,
Margaret O'Mara

MISS M. O'MARA

ATTACHMENT II

COMPARISON OF EXPORT CREDIT AGENCIES PREMIUM RATES

	5 years		8½ years		10 years	
	Best Markets	Worst Markets	Best Markets	Worst Markets	Best Markets	Worst Markets
Highest	5.90	9.20	7.00	12.00	8.36	11.69
2nd Highest	4.56	6.73	6.65	9.64	7.37	10.85
COFACE	1.98	4.59	2.79	5.39	3.09	6.09
ECGD						
Buyer Credit	1.65	4.36	2.04	4.82	2.31	5.14
Supplier Credit	1.65	4.63	2.19	5.38	2.51	5.92
2nd Lowest	1.57	2.10	1.50	2.81	1.86	3.41
Lowest	0.29	1.43	0.44	2.18	0.52	2.62
Arith. Mean	2.74	4.91	3.54	6.51	3.98	7.35
Middle Rate	2.46	4.70	3.15	6.58	3.60	7.79

Trade, Jan '82, ECOD



SECRET

Trade. 085

File 2

cc: Mr. Walters

10 DOWNING STREET

From the Private Secretary

25 October 1982

In their discussion this morning of the measures which might be taken to rectify the 1982/83 PSBR undershoot the Prime Minister suggested to the Chancellor that there might be a case for a once-off payment to ECGD during 1982-83. The Prime Minister understands that, following the losses of recent years, ECGD, given their requirement to break even, are charging high premia in relation to those charged by other official credit insurance agencies. What the Prime Minister has in mind is the possibility of making a once-and-for-all payment to strengthen ECGD's financial position, so as to moderate the pressure on their premia.

I would be grateful if you would let me have a note on the feasibility of this idea as a corrective to the undershoot in the 1982/83 PSBR; and if you would give this letter the usual restricted circulation.

M. C. SCHOLAR

Miss Margaret O'Mara,
H.M. Treasury.

SECRET

Trade

Confederation of British Industry
Centre Point
103 New Oxford Street
London WC1A 1DU
Telephone 01-379 7400
Telex 21332
Telegrams Cobustry London WC1

From
Sir Campbell Fraser
President

CBI CONFEDERATION OF BRITISH INDUSTRY

Prime Minister (4)

To note X

Noted MCS 6/10

5 October 1982

Dear Lord Carrington

As you may know the CBI has an Export Credit Committee, chaired by Lord Selsdon, which keeps under review the important field of export finance. We regard the financing of export trade as a major element in a company's success at winning foreign orders, especially when faced with difficult trading conditions: and Lord Selsdon's Committee reports regularly to our main Overseas Committee on this subject.

Earlier this year the Export Credit Committee decided to set up a working party under Mr Derek Glenton of Davy McKee, to review the Government's financial schemes for exports, in particular those operated by the Export Credits Guarantee Department, and to make recommendations concerning them.

I now have pleasure in enclosing a copy of the Working Party's report, which has been endorsed by the Export Credit Committee and the Overseas Committee. I am sure you will find this of interest; and I trust you will give serious consideration to implementing as many as possible of its recommendations.

The Working Party's report concentrates primarily on an examination of ECGD and its services. However the terms of reference also called on it to investigate the interest rate support provided by the Treasury under the OECD Consensus on export credit terms, and the Aid and Trade Provision in the ODA Vote.

I should emphasise that the CBI has in the past been generally satisfied with the quality of ECGD's service to its policyholders, on the basis that all UK export promotion services were maintained at a standard of effectiveness at least equal to those available to our major overseas competitors. Hitherto, therefore, our Export Credit Committee has only sought improvements to particular ECGD facilities or the creation of new forms of cover. However, in recent months there have been disturbing signs that ECGD's financial problems arising out of claims experience are affecting the quality of service. There are also some anxieties about the Department's organisation and structure: these are clearly not responsible for its present financial position, but it is at least questionable whether they are in the optimum shape to ensure ECGD's continued solvency and efficiency.

.../...

In putting forward its recommendations, the Working Party has avoided any proposal to increase beyond existing levels the public expenditure set aside for the promotion of UK exports. It has however suggested ways in which these resources might be refocussed in order to provide greater benefit to British exporters.

It is our intention shortly to publish the report, as a means of increasing awareness in the CBI membership of the valuable facilities provided by ECGD and promoting debate on how these might be further improved. Meanwhile I am copying it in advance of publication to those of your Ministerial colleagues who will be interested, and to certain senior officials, with some of whom it has already been informed discussed.

Yours sincerely
Campbell Fraser

The Rt Hon Lord Cockfield MP
Secretary of State for Trade
Department of Trade
1 Victoria Street
London SW1H OET

copy, with report,

to The Rt Hon Sir Geoffrey Howe QC MP
The Rt Hon Francis Pym MC MP
The Rt Hon Patrick Jenkin MP
Peter Rees Esq QC MP
The Rt Hon Neil Marten MP
Norman Lamont Esq MP
Barney Hayhoe Esq MP

M D M Franklin Esq CB CMG
K Taylor Esq CB idc
J Caines Esq
G S Downey Esq CB
Sir Peter Carey KCB
Sir William Ryrie KCB
R M Evans Esq CMG
C J Carey Esq
C B Benjamin Esq
F E R Butler Esq

CBI

CONFEDERATION OF BRITISH INDUSTRY

UK EXPORT CREDIT INSURANCE AND FINANCE

Report by a Working Party of the CBI Export Credit Committee

CBI PUBLICATIONS

Confederation of British Industry
Centre Point
103 New Oxford Street
London
WC1A 1DU

October 1982

CBI EXPORT CREDIT COMMITTEE WORKING PARTY

Chairman

Mr D Glenton	Davy McKee

Members

Mrs L Archibald	Lloyd's of London
Mr J S Bensley	BEAMA
Mr K W Cotterill CMG	Commercial and Political Risk Consultants
Mr A H Dunn	Morgan Grenfell & Co
Mr R Granger	Credit Insurance Association
Mr D V Wilson	British Aerospace

This report was approved by the CBI Export Credit Committee, 7 September 1982, and by the CBI Overseas Committee, 23 September 1982.

FOREWORD

The importance of international trade to the United Kingdom economy is often overlooked. Those of all political persuasions who put foward widely diverging proposals for solving our economic and social problems, tend to ignore the vital and irreplaceable role of trade.

Apart from the obvious balance of payments considerations it is worthwhile reminding ourselves of two important points:

Firstly, exports of goods and services account for approximately one third of our Gross Domestic Product.

Secondly, some 3.5 million jobs in manufacturing industry are directly dependent upon overseas trade, and it is probable that a total of some 7 million jobs in this country are directly or indirectly supported by the economic activity currently created by our exports.

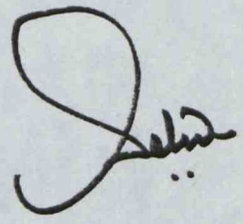
The relationship between finance and trade is historically a close one. However today export credit and bilateral or multilateral aid are not only important but often essential ingredients, without which export orders and markets will be lost to foreign competition.

My Committee and I are concerned that the importance of ECGD and the services that it provides, or could provide, are fully recognised. We also acknowledge the importance of the growing association between aid and trade.

We are therefore particularly grateful to the members of the Working Party who prepared this Report. As will be noted, they have a high level of knowledge and experience upon which to draw. They have also consulted closely with others in the public and private sectors.

In drawing up the report and its recommendations, the Working Party have concentrated upon the commercial interest of the UK. They would, I know, accept, particularly where bilateral aid is concerned, that political considerations may from time to time take precedence.

My Committee will now take steps to encourage the implementation of the recommendations made.



Lord Selsdon
Chairman
CBI Export Credit Committee

SUMMARY OF RECOMMENDATIONS

The Working Party's recommendations are set out in three sections. We have put forward a proposal for formulating the long-term strategy of ECGD, followed by short-term recommendations, realising that such a strategy could not be implemented immediately. We have also identified where action is needed in the provision of interest rate support and aid funds.

Long-Term Strategy for ECGD

1 ECGD as presently constituted cannot adequately meet the needs of the trading interests of UK exporters; the Working Party recommends that HMG should set up a Special Committee to examine the whole basis of ECGD's organisation and operation and to recommend what form the Department should take. The Working Party suggests one possible course of action: to establish ECGD on a more autonomous basis. (paras 21-25)

For Immediate Action

2 ECGD to introduce new forms of cover for both capital and non-capital goods to encourage the regrowth of the Department's business. (paras 27-30)

3 ECGD to alter the method of premium payment for buyer credits to reduce the cost effect on exporters. (para 31)

4 ECGD in co-operation with the banks to develop improved schemes for the smaller exporter. (paras 32-34)

5 ECGD to establish a dialogue with the private sector insurance market to explore in detail how they can co-operate for the greater benefit of the UK exporter. (paras 35-40)

6 ECGD to undertake an internal study on the Department's staffing structure. (paras 41-45)

7 ECGD to promote the utilisation of export credits in the low interest rate currencies under the OECD Consensus to reduce the cost of interest rate support. (paras 46-48)

8 The substantial saving forecast from reduced interest rate support should be utilised to increase those funds available for other forms of export support. (para 47)

9 The City and the UK exporters to explore opportunities of commercial funding when interest rates are below OECD Consensus levels. (para 49)

10 HMG to increase the amount of aid funds under the bilateral programmes, which are tied to the purchase of British goods and services. (paras 50-53)

11 HMG to increase the Aid and Trade Provision substantially and to examine the mechanism of distribution. (paras 54-55)

A INTRODUCTION

1 Since 1975 the UK's competitive position vis-a-vis other major trading nations has deteriorated sharply. Despite a slight improvement in our unit labour costs relative to our competitors since early 1981, we are still 30 to 35 per cent less competitive than we were seven years ago. This has been caused mainly by poor performance on both pay and productivity and compounded by a higher value of the pound sterling than our economic and trading performance could justify without the support of North Sea oil.

2 These factors have resulted in a decline in our export trade in real terms and in the relative profitability of our exports. In the last 10 years the UK's share of world export trade has fallen from over seven per cent to under six per cent. However, exports of goods and services still account for around a third of our gross domestic product, and must be considered as an essential part of the programme for the recovery of the British economy.

3 Financing arrangements, both commercial and assisted (including interest rate support and grant aid), play a more and more significant role in winning export orders. A major underpinning for exporters is the availability of export credit insurance, principally provided by the Export Credits Guarantee Department (ECGD), and also the provision of interest rate support in line with the OECD Consensus on export credit terms. This support and a pragmatic bilateral aid policy can do much to encourage exports and to provide employment and economic growth at home. The continued effectiveness of all forms of support for export financing is of major concern to companies engaged in international trade.

4 With this in mind, the Chairman of the CBI Export Credit Committee asked the Working Party in April 1982:

> "To review ways of reinforcing UK industry's competitive power overseas, with special reference to ECGD's services and related financial aids to exports, and to recommend any necessary action."

B ECGD

The Present

5 The publication of ECGD's trading results for 1980/1 confirmed worrying trends which have been causing concern to those who closely follow the Department's progress. During the last 10 years the overall percentage of UK exports covered by ECGD has declined from a peak of 36.3 per cent to 30.8 per cent. In the same period total claims paid annually increased from £32.3 million to £287.8 million, an eight-fold increase, while premium income failed to keep pace, increasing from £22 million to £150 million, a six-fold increase. These results reflect both the effects of recession on individual buyers and the failure of entire markets in which ECGD has been heavily committed; for example, Iran, Turkey, Poland, and more recently, Argentina.

6 These difficulties have led some commentators to speak in extreme terms of the "bankruptcy" of the Department, and of the likelihood of drastic changes in its operations. As justification, they point to the requirement that it operates most of its business at no net cost to the taxpayer and to the serious depletion of its cash reserves. ECGD itself has referred to these factors in seeking to justify the three increases in premium rates it has imposed upon policyholders since April 1979.

7 As a Government Department, ECGD is able to borrow from the Consolidated Fund and it cannot be faced with bankruptcy in the way that would affect a commercial enterprise. However, although it would be open to the Department to borrow from the Consolidated Fund it would become liable for interest payments. The effect of such borrowing would in addition be likely to result in considerable pressure for radical economies and increased Treasury control over ECGD's day-to-day operations. Exporters would almost certainly be the losers if action was taken along these lines.

8 The Working Party takes the view that many of ECGD's problems stem from events over which the Department has no control. The world recession has adversely affected the economies of many of the UK's major trading partners. Furthermore, political and financial instability of key markets has hit credit insurers abroad with equal strength, and all have suffered from a sharp increase in claims stemming from both political and commercial causes of loss. It would thus be a mistake to assume that ECGD's current financial difficulties are a reflection of organisational weakness; for most of its post-war history the Department has not only remained in the black - it has also succeeded in providing a broadly efficient service which has met the needs of exporters.

9 Satisfaction with the quality of ECGD's service to its policyholders has been reflected in the CBI's policy, as recommended by its Overseas and Export Credit Committees and endorsed by Council. The CBI position has been that all UK export promotion services, including ECGD, should be maintained at a standard of effectiveness at least equal to those available to our major overseas competitors.

10 However, there have been disturbing signs recently that ECGD's financial problems have begun to affect the quality of service provided. Higher

premiums have encouraged policyholders to examine more closely the benefits they receive for their money, and there has been strong criticism when facilities have been withdrawn or cover restricted, particularly when this has happened at short notice. This criticism carries weight particularly since it arises predominantly from the larger holders of comprehensive guarantees who are in constant contact with the Department and who are best placed to make comparisons with facilities available abroad and on the private market.

11 The CBI Export Credit Committee has frequently called for improvements to particular ECGD facilities or the creation of new forms of cover. In some areas it has been critical, but it has not sought to question, or to review, the structure and financial mandate of the Department, nor the basis of its operation. The CBI has accepted the overriding requirement that ECGD should operate its Section 1 and Section 2 (of the Export Guarantees and Overseas Investment Act 1978) business on a break-even basis, taking one year with another, although recommending that this requirement be interpreted in such a way as to avoid imposing premium rate increases on exporters at times when trading conditions are at their worst.

12 The CBI has also accepted in the past that the comprehensive principle by which ECGD operates its short and medium-term business is in the best interests of exporters as a whole, keeping premium rates at reasonable levels in return for a wide spread of markets covered.

13 Events have thrown open these and other central policy assumptions. While ECGD's organisation and structure may not themselves be responsible for its present financial predicament, it is at least questionable whether they are in the correct shape to ensure the Department's continued solvency and efficiency.

The Future

14 In interpreting its terms of reference, the Working Party principally concerned itself with an examination of business done under Sections 1 and 2; with the funds provided for interest rate support to OECD Consensus levels; and with funds allocated to the Aid and Trade Provision, administered by the Overseas Development Administration in co-operation with the Department of Trade.

15 Given the development of the private market for certain types of cover in recent years, we addressed ourselves at the outset of our deliberations to whether it was necessary for the Government to continue to operate an export credits guarantee department at all. Our view was that within the foreseeable future there would remain a need for the Government to assume certain key risks in overseas trade which, either because of their magnitude or their duration, it was not practicable to expect the private market to assume unaided. We take the view, however, as outlined below, that there is considerable scope for the expansion of private sector co-operation with ECGD.

16 ECGD is called upon under Section 2 to operate certain facilities, which cannot be justified on a purely commercial basis, in the national interest. This Account has hitherto been kept in the black and has cost

the taxpayer nothing. However the taxpayer has been called upon to meet the cost of interest rate support for capital projects at a level of around £500 million in the last financial year (this will eventually decline as market rates fall), and for the costs of Cost Escalation Cover and the Aid and Trade Provision, quite aside from the various BOTB facilities.

17 Radical critics are sometimes inclined to question the value of Government support for exports on any but the most temporary basis, especially in view of the UK's current trade surplus. They argue that exports of goods and services only have value in so far as they enable the UK to balance its payments. This is not the view of the Working Party. We believe that certain support is required to facilitate the sale abroad of the output of much of British manufacturing and service industry. Furthermore, this appears to be the experience in all other trading countries. The importance of maintaining the competitiveness of manufacturing industry as an "engine of growth" is attested by the record of West Germany and Japan, and it may not be possible to rely indefinitely on a large surplus on the invisibles account, given the increase of non-tariff barriers in this sphere. Many of the firms which benefit from export assistance are amongst the UK's most significant employers. Notably in the case of capital goods exporters, these are frequently located in areas of high structural unemployment and reliant on world-wide sales to provide an adequate market for their specialised products and to maintain their work forces.

18 The Working Party considered it neither appropriate nor practicable to arrive at a blueprint for the evolution of ECGD in the years ahead. The CBI does not have access to all the sources of information necessary for detailed analysis of ECGD's current financial situation and possible remedies.

19 At the same time our discussions have led us to believe that there are certain courses of action which can and must be explored in the interests both of the Department and of British exporters. It is our view that if ECGD is to continue to meet the needs of British industry in the years ahead then change will be necessary and Ministers and officials should give serious consideration to the form that it should take.

20 Our recommendations have been divided into three parts:

i the Working Party has put forward its recommendations for formulating a long-term strategy for ECGD;

ii realising that such a strategy is not amenable to early implementation, we have identified certain areas where there is scope for reform in the interim provided that it is preceded by careful discussion and consultation with all interested parties. This process should begin immediately, but its overall pace will be dictated by events;

iii the Working Party has put forward proposals in the fields of interest rate support and aid funds to assist further the UK exporter.

Long-term Strategy - a Root and Branch Approach

21 The Working Party considered what form an organisation would take if it were established today to provide credit insurance cover and finance for British exporters of goods and services. Our unanimous opinion was that such an organisation would be structured along significantly different lines from that of the present day ECGD. We therefore concluded that ECGD needs to undergo substantial change over a lengthy period of time, despite the obvious transitional problems that would ensue.

22 We strongly advocate that the Government should set up a Special Committee to examine the whole basis of ECGD's organisation and operation and to recommend what form it should take in the future. It is suggested that this Committee should be made up of representatives of the Government Departments mainly concerned, informed representatives of the exporting community, and of financial and insurance institutions. The Committee, under an independent chairman, would consider evidence from all interested parties.

23 We consider that one possible solution would be to establish ECGD on a more autonomous basis, writing Section 1 business on its own account and, perhaps, continuing to act as agent for the Government for Section 2 business.

24 The Working Party envisages an arrangement which would afford the restructured Department the freedom to recruit personnel and to operate along self-determined commercial lines, no longer under so much political pressure to accept unprofitable business, but rather tailoring its policies and its premium levels to the market in consultation with both exporters and brokers. The National Interest Account business might then be directly under the control of either the reorganised ECGD acting as agent, or the Department of Trade, or, possibly, a separate Ministry of Exports, incorporating also the functions of the DoT's Projects and Export Policy Division and certain functions of the Overseas Development Administration. This would provide a single focus for decision-making on matters of export policy and support where Government assistance was required.

25 The Working Party feels that the point has been reached where ECGD is being asked to serve too many masters with different and sometimes conflicting motives and that it would serve industry better if it had greater freedom of decision-making within set financial criteria. We acknowledge the fact that such an agency would have the ability to be selective in its business. The interests of all exporters must be borne in mind in any recommendations that are made.

The Shorter Term

26 The Working Party does not underestimate the task which would face this Committee but sees a real need for the fundamental examination proposed. However time is of the essence if exporters are not to be disadvantaged meanwhile by a curtailment of ECGD services. The Working Party has therefore concluded that certain steps should be taken immediately or in the short term to alleviate ECGD's financial problems and at the same

time benefit British exporters without prejudicing the need for more long-term change.

Operating Flexibility

27 Over three-quarters of ECGD's business consists of insuring goods sold on short and medium-term credit and covered under its Comprehensive and Extended Terms Guarantees. Inevitably, many of the Department's most serious financial problems spring from losses suffered on this business. While in the past much attention has been focussed on export support for major project business, we welcome the increased discussion of how to ensure that ECGD services as used by most policyholders are as efficient, responsive to demand, and financially sound as possible. The formation of the Export Credit Insurance (Comprehensive Guarantees) Group, sponsored by the CBI and other trade associations, offers a very useful channel of direct communication between active industrialists and ECGD's Comprehensive Guarantee Division in Cardiff.

28 ECGD has adhered rigidly to certain central principles which have determined the development of its services since the war. The Department has not been prepared to separate political and commercial risks and allow cover for one without the other. It will not negotiate a lower indemnity in return for a lower premium rate. First loss cover and "datum line" cover have been tried experimentally, but little progress has been made as a result of ECGD's overriding commitment to the whole-turnover principle.

29 The Working Party recommends that the possibility of making new forms of cover available for both capital and non-capital goods in addition to the existing range of ECGD facilities should be actively investigated by the Department. The prospect of increased competition from the private market should result in ECGD being more prepared to tailor policies to meet the individual needs of exporters rather than simply offering take-it-or-leave-it terms. At present many exporters do not hold ECGD policies because the terms of the existing Comprehensive Guarantee do not meet the needs of their business. A greater range of special endorsements and options might serve to boost premium income significantly and avoid the vicious circle of decline which is a real prospect for the future. Private market experience suggests that a limited number of existing policyholders will opt for selective new forms of cover to the exclusion of general cover. The Working Party is therefore of the opinion that the introduction of new policies on the above lines will stop the decline and lead to the regrowth of ECGD's business.

30 On the more general issue of operational procedures, we welcome the consultations which have taken place so far with the Export Credit Insurance (Comprehensive Guarantees) Group on how this might be improved. The Working Party fully supports this development and hopes to see further progress ensue. As ECGD premium rates rise, exporters will increasingly scrutinize the services provided by the Department before renewing policies. It is central to ECGD's future viability that it is seen to provide value for money. Complaints about delays and inflexibility arise; sometimes they are without foundation, but too often they are not. Many industrialists who deal with ECGD frequently have

first-hand experience of procedures and service which would not be tolerated in a well-run commercial enterprise.

31 In the field of buyer credits the Working Party feels that ECGD's premium rates have increased to the point where they are imposing a considerable burden on exporters and can sometimes exceed the initial downpayments to be received under a contract. We recommend that serious consideration should be given by ECGD to changing the system in such a way as to enable these charges to be recovered in other ways designed to reduce their cost effect on exporters.

The Smaller Exporter

32 In 1980/1 15 per cent of guarantees accounted for 80 per cent of ECGD's insured turnover on short-term business. Very many of ECGD's 11,000 policyholders have a comparatively small export turnover; in some cases we understand that the premiums paid fail even to cover the expenses involved in administering their policies. The Working Party takes the view that it is essential that every assistance be given to these small firms to help them to export efficiently and to grow, and we welcome the moves made by ECGD to simplify the documentation and procedures with which policyholders have to contend.

33 Recently several banks have initiated schemes under which they provide group insurance with ECGD for smaller exporters. Not only do these schemes have the potential to remove a considerable administrative burden from ECGD; they might also provide greater access for small firms to specialist advice on a range of financial matters. If the scope of these schemes could be expanded - for instance by raising the existing ceiling for eligibility - then it would be possible for ECGD to move away from detailed administration of some of its policies and operate as a centralised insurer or even reinsurer of business written by the banks.

34 We therefore recommend that early talks should be held between ECGD and banking industry representatives to explore what can be achieved to enhance and safeguard the interests of the smaller exporter.

Private Market

35 Insurance against commercial risks, traditionally covering insolvency and default, is available in the private market. Political risk insurance is not only available in the Lloyd's, London, and international markets, but is also available in the company market. In all cases, it is exceptional for cover to extend beyond five years. The private sector normally offers insurance on a selective basis, tailored to an exporter's specific needs.

36 Recent years have seen the development, by new companies and brokers, of specialist forms of cover. Although in the past the private market has tended to concentrate on filling the gaps in ECGD services, there is an increasing tendency for it to offer forms of cover which are in direct competition with facilities offered by ECGD. The Working Party welcomes this competition as in the best interests of exporters and looks forward to its extension, but we recognise that it also presents ECGD with a challenge.

37 In our view it would be unfortunate if ECGD allowed its own position to be eroded to the point where it was left to provide cover only for business which the private market would not handle. It is vital that ECGD should not allow this to happen and that the Department rise to the challenge posed by new private market facilities.

38 The Working Party believes that there is scope for more co-operation between ECGD and the private sector. We take the view that their combined strengths in a number of areas could, if properly harnessed, contribute greatly to the expansion of export credit insurance facilities. The Working Party recommends that a dialogue should be established as soon as possible between ECGD and the appropriate private sector representative bodies to explore in detail how they can co-operate to the greater benefit of exporters.

39 We understand that there is a feeling among private sector underwriters that the whole-turnover requirements of ECGD impose a strain on the ability of the private sector to compete on equal terms, since exporters using the ECGD Comprehensive Guarantee are prevented from using the services of the private sector to obtain more specific cover for certain areas.

40 The Working Party is aware of the more flexible approach currently being adopted by ECGD to the whole-turnover requirement with more attention being given to the quality of business offered rather than to a rigid formula for the percentage of business covered. The introduction of new forms of ECGD cover which allow greater selectivity of risk by the policyholder is highly desirable. In addition, since the European Commission has adopted a European Parliament view that public and private credit insurers must compete on equal terms for intra-Community business, we recommend that immediate consideration should be given to reviewing the implications of implementing this in the UK, for ECGD's future viability, the private insurance market's capacity, and the cost and scope of credit insurance facilities for the exporter. This should be carried out with due regard to the obligation placed upon HMG by the Accession Treaty of 1973.

Personnel

41 ECGD is unusual in that it is a Government Department, coming under Ministerial control and staffed by civil servants, which provides a service to exporters, operating on a commercial basis. Although ECGD is under an obligation to break even and its staff carry out tasks which are more related to the City than to Whitehall, the Department has far less autonomy than the nationalised industries. It is bound by Civil Service policy on rates of pay, recruitment, promotion, procurement and other restrictions.

42 CBI members frequently express their admiration for the high calibre of staff they encounter in ECGD, and within the existing constraints these personnel undoubtedly do all they can to be of assistance to policyholders. Nevertheless there is often concern at the restraints placed on the introduction of efficient and businesslike procedures within the Department.

43 The Working Party shares these concerns as to whether it is reasonable to expect ECGD to operate as a business, charging a commercial rate for its services and meeting competition from the private sector, while at the same time requiring it to operate within policies and procedures primarily intended for purely administrative departments. For instance, given the fact that ECGD's administrative costs are included within its trading account and have to be covered by premium income it is unfair to expect the Department to absorb staff cuts as part of overall Whitehall policy.

44 We believe that greater efficiency of operations must be central to ECGD's health in the coming decade and beyond, and we recommend that it should be tackled as a matter of the utmost urgency. In particular steps should be taken to initiate a staff structure comparable to those in both industry and commerce to avoid staff loss due to low emoluments.

45 We also consider that it would be to the benefit of the Department, exporters and the City financial institutions if there could be more frequent interchange of personnel between them. We would like to see an internal study undertaken by ECGD to ascertain how these recommendations might be implemented.

C OTHER RECOMMENDATIONS

Interest Rate Support

46 The provision of interest rate support for capital goods exports down to the levels specified under the OECD Consensus on export credit terms has become a major charge on public expenditure. The cost of this can be expected to decrease from its peak of around £500 million per annum as UK market rates fall, and as a result of agreed rates under the OECD Consensus being raised in July 1982. Nevertheless it is inevitable, against the background of a uniform interest rate matrix below commercial rates, that those countries with high domestic inflation and interest rates will incur a higher cost for the blanket support of export credit funding than countries with lower rates. Any upturn in UK market rates would again call for increased levels of support; meanwhile the cost of support on running contracts has to be met.

47 The Working Party recognises the immediate necessity of ensuring that the competitive position of British capital goods exporters is safeguarded in world markets. In the medium and longer term the successful management of the UK economy in reducing rates of inflation and interest will mean a reduction in the cost of interest rate support. We think it is important that the resources thus saved should be used to increase those funds available for other forms of export support, but bearing in mind the constraints placed on Government by the GATT Code on Subsidies.

48 The cost of interest rate support can also be reduced by the funding of export credits in the lowest interest rate currencies available, and we therefore recommend that steps be taken to encourage this. This implies that the facilities available to protect exporters against the effect of exchange risk, in both the pre and post contract phases, must be fully effective. The recent announcement of facilities for financing in yen of UK exports is therefore a step in the right direction; but the Working Party sees no reason why this facility should be a purely reactive one. On the contrary, exporters should be actively encouraged to use it aggressively to win business. If the commercial market is unable to raise funds in low interest rate currencies then the Working Party would welcome legislation to allow ECGD to do so.

49 It is possible in a cyclical interest rate down-turn, that there may be prolonged periods during which commercial interest rates in most currencies lie below the Consensus levels. We recognise that such a situation should provide opportunities for UK exporters working with the City to enable operations to be implemented on a pure cover basis, perhaps funded from other than banking sources, with terms (in particular final maturity) not constrained by the OECD limits. This would provide the UK with opportunities to match the very long periods made available from time to time from, for example, the Export Development Corporation of Canada. The Working Party hopes that exporters and financial institutions will be able to exploit these opportunities as they arise, and that international arrangements would not prevent this being done.

Aid Funds

50 The development of the economies of the poorer nations of the world is a

political and humanitarian obligation on governments such as HMG, which industry accepts. A consequence of successful development is the creation of new markets and it therefore assists the overall growth of the world economy, which is a prerequisite for raising the level of prosperity for all nations. Industry therefore has both a direct and an indirect interest in the government's aid programme. Insofar as aid funds are spent on the supply of manufactured goods, British industry seeks appropriate commercial return.

51 The Working Party notes that in its evidence on Aid Policy to the House of Lords Select Committee on the European Communities in January 1981, the CBI called in the present circumstances for the greatest possible proportion of the UK aid effort to be channelled through bilateral programmes, as the greatest part of UK bilateral aid is tied to the purchase of British goods and services benefitting British industry in direct proportion to the funds made available by HMG. Bilateral aid is concentrated on Britain's traditional markets and the UK Government can determine its allocation. This compares with evidence which suggests that the UK's contribution to some multilateral aid programmes generates more business for our overseas competitors than for UK firms.

52 At present many of the most important opportunities for new capital projects arise within developing countries. Recessionary pressures mean that competition for these is particularly fierce, and success or failure may depend on the willingness of governments to make available aid funds to soften commercial credit terms. The present situation where these funds distort open market competition may well be regretted; however it cannot be ignored.

53 In these circumstances the Working Party takes the view that it is no longer adequate for the UK to pursue a policy which is essentially reactive and which places emphasis on the matching of competitors' terms. Competition between governments in the provision of assistance for the financing of key projects is now as much a reality of the marketplace as competition between manufacturers and contractors, and we hold the view that UK policy should take account of this fact. There have recently been welcome indications that the UK is prepared occasionally to take the initiative; this should happen more often.

54 For these reasons we recommend that the allocation of funds to the Aid and Trade Provision (at present around seven per cent of the total bilateral aid budget) should be substantially increased. The ATP has proved itself successful in generating substantial business in return for a relatively modest outlay. Since 1977 £1,110 million worth of export orders have been won with the assistance of £252 million in trade-related aid, ie £100 million of ATP generates business of £440 million. On the question of jobs the Minister for Trade stated earlier this year "..... if you take one broad estimate, each £17,000 of exports saves or creates one job in the short term .....". If we take this government estimate, then those export orders secured by ATP to date represent over 65,000 jobs. As ATP funds are used only to "top up" sound commercial bids, they represent outstanding value for the taxpayer's money. They can also be used to win new business in markets where the UK has not in the past operated a substantial aid programme.

55 The first step should, therefore, be to find a means of increasing ATP funds, to provide more resources set aside to assist commercial projects, which we believe is a prerequisite for UK firms to remain in competition for major capital project business on world markets. We feel that the potential for increased and effective use of the ATP concept is considerable. Such an increase in ATP could be brought about by an increase in the total aid budget over a period of time, or by placing greater emphasis on the bilateral allocation. The mechanism and the responsibility for the allocation of such funds would need to be re-examined with the object of giving the Department of Trade a greater or overriding say in determining priorities.

56 The Working Party sees, as a related problem, the disadvantages which certain of our firms suffer as a result of countries such as the US and France providing aid for the purchase of military equipment - a practice which the UK does not adopt.

57 We recommend that the Government should seek to discourage other governments from providing military aid of this kind, and should examine the ways in which exports of UK defence equipment should be financed in the future.

D CONCLUSION

58 Our discussions have led us to believe that the time is right for a fundamental examination of ECGD, to ensure that British industry enjoys in the future a comprehensive range of export promotion services at a standard of effectiveness at least equal to those available to our major overseas competitors. In the short term we see the need for changes in ECGD's financial operations and schemes backed by discussions with banks and insurance brokers aimed at creating a more efficient operation.

59 In our recommendations we have sought to avoid the need to increase the public expenditure set aside for the promotion of UK exports beyond existing levels, whilst suggesting ways in which it might be redirected to provide greater benefit for British exporters, eg through a larger proportion of the Government's aid budget being given to the Aid and Trade Provision.

60 The Working Party emphasises that greater attention should be given to the short-end of ECGD's business, which takes up the greater proportion of time and resources. Although we recognise that the projects-end of the business is not perfect, consultation between the Department and industry has been very much more frequent in this area.

61 We stress that a piecemeal approach is no longer adequate to meet the demands of the situation, and that a general and thorough reiew of ECGD's area of operation must now be a priority for Government.

CF

. Have you a home for this?

2

PRIME MINISTER

Trade.

I attach a glossy booklet circulated recently by the ECGD to businesses in the North of England. We have already had a couple of letters of complaint, and we have asked Mr. Nott to reply. It does seem to me to be a ridiculous example of unacceptable Government extravagance in the current circumstances.

MTF

MTB

12 November, 1980.

ECGD

1931 1932 1933 1934 1935 1936 1937 1938 1939 1940

50

1941 1942 1943 1944 1945 1946 1947 1948 1949 1950

YEARS

1951 1952 1953 1954 1955 1956 1957 1958 1959 1960

IN THE

1961 1962 1963 1964 1965 1966 1967 1968 1969 1970

NORTH

1971 1972 1973 1974 1975 1976 1977 1978 1979 1980

ECGD's 50 years in the North

1980 marks the fiftieth anniversary of the establishment of ECGD's first office in the North – in Bradford – the precursor of several ECGD offices which served exporters in Yorkshire, Humberside and the north-east of England, before the opening eight years ago of the present regional office in Leeds. This booklet has been produced as a memento of the golden jubilee of ECGD's presence in the region. It is addressed to all those engaged in export business – producers and sellers of goods and services, bankers, brokers, chambers of commerce, trade associations, government departments, and ECGD staff (past and present) who have given service in the region.

The early years

From ECGD's earliest days the textile industry has, among others, made the fullest use of the credit insurance services offered by ECGD. Just nine years after ECGD opened its doors for business in the City of London in 1919, the first branch office was set up in Manchester with the aim of building up a closer working relationship with Lancashire cotton exporting firms. It was perhaps a natural development that the second ECGD branch office should be set up in the woollen industry's 'capital city' of Bradford. These two offices laid the foundations of ECGD's continuing policy of being 'on the doorstep' throughout the UK to deal with industry's export credit insurance problems. The Bradford Office was followed by the setting up of branches in Birmingham (1934), Glasgow (1935), Sheffield (1938), and Newcastle (1939). These pre-war offices were initiated with the active and willing co-operation of local chambers of commerce who in each case provided a room as a base-office for ECGD's representative.

The establishment of the original Bradford Office in 1930 broadly coincided with the emergence of ECGD from its experimental years. It was during the 1930s that the basic principles of credit insurance as we know it today became established. 1930 was also the year in which ECGD became an independent department with its own Parliamentary 'vote.' The first 'whole-turnover' guarantees covering exporters against the risks of overseas buyers' defaults and insolvencies were issued the following year and a standard comprehensive policy was introduced in 1932. By the mid-1930s ECGD was starting to provide cover against the political risks of loss; a time which also saw the beginnings of ECGD's involvement in guarantees for medium-term credit for overseas projects such as railway electrification schemes and the construction of iron and steel plants. By the outbreak of the second world war, the two main features of ECGD insurance – the 'whole-turnover' principle, and the coupling of buyer risk cover with that for political risks – were well established.

The post-war years

The years of the second world war saw ECGD faced with the particular problems of insurance against war risks. Nevertheless, it was also a period when with considerable foresight the Department planned for a resumption of normal trading conditions and for the expansion of its services to meet the needs of British exporting industry in a world where the old sellers' markets for British goods had disappeared for ever, and where increasing international competition was to be the order of the day. As world trade expanded, particularly in connection with the post-war industrialisation programmes of many developed and developing countries, so credit increasingly became an essential element of the new competitiveness. In 1947 ECGD covered a modest 11 per cent of UK exports; by the end of the 1950s 20 per cent had been reached, and 30 per cent by the mid-1960s. Since that date the figure has fluctuated between 30 and 38 per cent.

The most significant development during the 1950s was the introduction of direct ECGD guarantees to banks providing export finance. With these guarantees exporters could obtain post-shipment finance at favourable interest rates. At first the facility was confined to machinery and similar exports covered by ECGD on a case-by-case basis under specific guarantees; the inauguration of direct bank guarantees in conjunction with comprehensive guarantees did not occur until the mid-1960s. Meanwhile ECGD had been developing buyer credits for large project business; but the operation of cover for such projects has always remained a function of ECGD's London Head Office. The main development affecting ECGD's regional offices was a steady expansion to deal with the growing number of policy-holders. By the early 1970s ECGD had expanded the number of branch offices to 20, all situated in main commercial centres.

ECGD's first Leeds Office was an early response to this post-war expansion, opening for business at Cabinet Chambers, Lower Basinghall Street in the latter months of 1949. It continued to make an important contribution to the growth and development of ECGD's comprehensive facilities during the 1950s and 1960s, and provided valuable and increasing support for local business.

In 1972, as part of the activity following the publication of an independent review of the Department's functions led by Mr David Scholey, it was decided that in place of 20 branch offices there should be ten regional offices serving larger areas than their predecessors and taking on many functions formerly the prerogative of the London Head Office. Leeds was the first of the new style regional offices to come into operation, opening at Otley Road, Headingley in September 1972. The last Bradford Office at West Riding House, Cheapside closed in September 1972: the Newcastle and Sheffield Offices shut their doors in November of the same year.

After three years in Headingley the Leeds regional office moved to its present city centre address of West Riding House, Albion Street. The region served by this office now stretches from the Scottish border to the outskirts of Lincoln, and from the North Sea coast to the Pennine borders of Lancashire and Cumbria.

ECGD 50 YEARS IN THE NORTH 1930-1980 ECGD



ECGD today

Today, ECGD's Leeds Office has a staff of 50 divided into five sections. One deals with exporters' all-important applications for credit limits on overseas buyers; another gives advice on probable loss situations and handles preliminary processing of claims documentation. A third section is responsible for the underwriting and issue of new and renewed policies. Premium payments amounting to over £4 million a year are handled by the Premium Section, and the Marketing Section is responsible for visits to exporting firms. This section undertakes the great majority of the 2,000 or so calls to each firm made each year by Leeds Office staff.



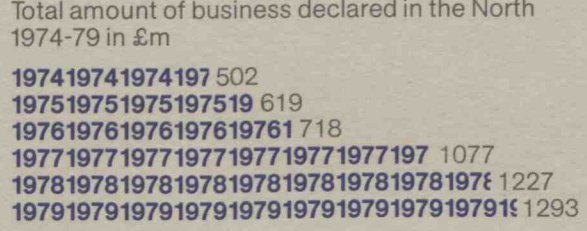
Bill Ford, who has been Director of ECGD's Leeds Office since the regionalisation programme of 1972, sees the office's main responsibility as carrying on the long tradition of actively taking export credit insurance to the region's businessmen: 'Although we now serve a large region with several major industrial centres, it remains our aim to build up good working relationships with companies wherever they may be situated. Those firms who are already policy-holders have regular direct contact with the office in connection with such things as credit limit applications on new and existing buyers, renewal of policies and potential losses. As to the uninsured, our marketing officers have found from contact with firms over the years that there is widespread awareness of ECGD's existence, but sometimes a lack of appreciation of the many benefits which our facilities can bring to their business.'

ECGD 50 YEARS IN THE NORTH 1930-1980 ECGD

ECGD policies serviced by the Leeds Office 1972-80



Total amount of business declared in the North 1974-79 in £m



A full indication of the developing role played by ECGD in supporting exporting industry can be gauged from the graphs above. After nearly a decade of operation as a regional office, Leeds can show impressive growth. The value of business insured in 1973-74 stood at £500 million; by 1979-80 it had reached £1,293 million. The number of policies held by firms in the region has steadily increased from under 1,600 in 1973 to nearly 1,800 today.

ECGD 50 YEARS IN THE NORTH 1930-1980 ECGD

A more colourful representation of the part played by Leeds Office can be given by listing some of the region's goods sold abroad with ECGD support. The textile and engineering industries remain among the more important users of ECGD's facilities, but ECGD is also engaged in supporting industries as diverse as those producing–and exporting–artists' brushes, live maggots for anglers, pigs for breeding, chemicals with a variety of end uses, toys, and foodstuffs as various as frozen pastry and chocolate on the one hand, and seafoods, including lobsters, on the other.

And the development of ECGD's services from Leeds continues. Like all ECGD regional offices it is now linked by visual display units (VDUs) with the Department's Cardiff-based computer, on which is stored status information on buyers world-wide. In total ECGD carries information on some 150,000 firms in approximately 180 markets. The development of a computer system is already bringing benefits to both ECGD and policy-holders, as increasing numbers of 'credit limits' are underwritten in Leeds without the need to refer applications to headquarters. Exporters are now getting same-day decisions on some 30 per cent of such applications compared with about 5 per cent before the installation of VDUs.

In total, the Leeds Office receives applications for credit limits on overseas buyers at the rate of some 450 a week. Andrew Lane, Deputy Director of the office explains, 'It is the credit limit service which lies at the heart of ECGD's services to exporters. Most firms in this region know that if they are to expand their overseas business without the fear of crippling losses they must have credit insurance. But, quite understandably, they want decisions on the credit-worthiness of overseas buyers to be made as quickly as possible. We are continuously trying to speed up the decision-making process – and every improvement is all to the good for the region's exporters. But, in the end, ECGD's credit limit service is only as good as the information it receives from overseas sources. With buyers on whom ECGD has no previous knowledge, reliable information is not usually obtainable at short notice. In these cases we have to wait for the information to come to hand – the major factor in the 'turn-around' time of applications on such buyers.'

For the great majority of firms in the North, Leeds is the only ECGD office they will need to have direct contact with. In addition to its central role in connection with the basic ECGD guarantees for short- and medium-term credit for overseas sales, Leeds Office is frequently called upon to give information on the Department's other facilities, such as guarantees for post-despatch bank finance, cover on business expressed in foreign currencies, guarantees for performance bonds, guarantees for business done with and by overseas subsidiaries or associated companies, buyer credits, lines of credit and so on.

ECGD 50 YEARS IN THE NORTH 1930-1980 ECGD

Prospect

Competition for export contracts has never been stronger than it is today, with British firms facing a daunting task to retain their competitive edge against the vigorous challenge of foreign rivals in both the well-established trading nations and in the newly industrialised countries. An equally challenging problem for world trading arises from the economic and political instability of several – mainly newly emergent – nations among which are a number of the UK's traditional trading partners. In 1979-80 ECGD paid out a record of about £250 million in claims; of this about £180 million arose from country causes of loss – mainly overseas governments with serious economic problems preventing or delaying the transfer of payments. In comparison, five years earlier in 1974-75, ECGD paid out a total of £30 million, of which only £16 million was attributable to country causes of loss. Without officially backed credit insurance today's losses from non-payment on exports could mean for some companies not just a reduction in earnings but dire solvency problems.

The challenge of the years ahead in an ever-changing world is faced with confidence and determination by Leeds Office. ECGD's record of service to exporters during 50 years' presence in the region will stand it in good stead, as will the goodwill and understanding afforded by the exporting community during that time. It is in acknowledgement of this spirit of co-operation that ECGD offers this commemorative booklet to all those in the region involved in exporting – and to the Leeds Office as it prepares for the next half-century.

What is ECGD?

The Export Credits Guarantee Department is a government department responsible to the Secretary of State for Trade. It helps British exporters of goods and services in two main ways. First, ECGD insures exporters against the risks of not being paid by their overseas customers – whether through the default of the buyer or through other causes, such as exchange difficulties in the buyer's country. Second, ECGD gives guarantees to the banks under which exporters can obtain finance for their export transactions, often at favourable rates of interest. ECGD also insures new investment overseas.

ECGD's Head Offices are in London and Cardiff, and it has ten regional offices (Leeds, Manchester, Birmingham, Bristol, Belfast, Glasgow, Cambridge, and three in London) serving over 12,000 exporters up and down the country.

ECGD's Leeds Office
West Riding House
67 Albion Street Leeds LS1 5AA
Telephone Leeds 450631 Telex 55125
Regional Director Mr W Ford

ECGD's Head Office
Aldermanbury House
Aldermanbury London EC2P 2EL
Telephone 01-606 6699 Telex 883601

ECGD 50 YEARS IN THE NORTH 1930-1980 ECGD

Prepared by the Export Credits Guarantee Department and the Central Office of Information 1980
Printed in England for Her Majesty's Stationery Office by UDO Jenn Ltd., London, EC1
Dd 8202011 Pro 15020

Trade

CONFIDENTIAL

DEPARTMENT OF TRADE
1 VICTORIA STREET
LONDON SW1H 0ET

TELEPHONE DIRECT LINE 01 215 5144
SWITCHBOARD 01 215 7877

From the
Minister for Trade

Sir Keith Joseph MP
Secretary of State for Industry
Department of Industry
Ashdown House
123 Victoria Street
London
SW1E 6RB

NBPT

25/3

24 March 1980

Dear Keith,

John Nott has asked me to reply to your letter of 5 March following his of 17 January to Geoffrey Howe about the financial strains on the Export Credits Guarantee Department.

I fully share your view about the crucial importance of ECGD's facilities, and the degree of risk-taking which underlies them, for the competitiveness of many categories of exporters; and I very much hope to continue the policy of ensuring that these facilities broadly match those available to our competitors. Nevertheless, exports which are not paid for at all, or only after protracted delays, are hardly of benefit to our economy; and, in other instances, the total cost to public funds of export support can go beyond what is sensible. It is with cases of this sort that my letter was concerned.

As you say, ECGD's premium structure reflects market risks for capital goods exports on credit terms (as distinct from the flat rate system adopted, for speed and simplicity of operations, for the great mass of exports on cash or near-cash terms). In this, it is very similar to our main competitors' systems although, because of increases in recent years due to rising losses, our premiums for capital goods exports are now fairly high by international standards.

However, unless set at levels which would patently price our goods out of the market, selectively increased premiums would not turn a bad risk into an acceptable one; and resultant losses could require further increases all round, to the detriment of our better types of business. My officials will be glad to discuss these aspects with yours. On balance, I believe that over the years ECGD's commercial judgment has enabled just about the right path to be picked between all the conflicting considerations to which you refer.

I am copying this letter to the recipients of yours.

Yours ever,
Cecil

CECIL PARKINSON

24 MAR 1960

Trade.

CONFIDENTIAL

MINISTRY OF DEFENCE
MAIN BUILDING WHITEHALL LONDON SW1A 2HB
Telephone 01-218 2111/3 (Direct Dialling)
01-218 9000 (Switchboard)

MO 6/13

21st March 1980

Dear John,

My Secretary of State has seen the Industry Secretary's letter of 5th March to your Secretary of State in which he comments on the role of the ECGD in support of exports. My Secretary of State's particular interest in this issue is, of course, with the export of defence equipment. My Secretary of State thinks that it is right to stress the importance of the ECGD continuing to respond flexibly to applications for export credit insurance and to avoid putting UK companies at a disadvantage by an over cautious approach.

I am copying this letter to Michael Alexander (No 10), Martin Hall (Treasury), Catherine Bell (DOI), David Wright (Cabinet Office).

Yours sincerely

J D S Dawson

J D S DAWSON
Private Secretary

J Simes Esq
Department of Trade

CONFIDENTIAL

24 MAR 1960

JU

Trade

CONFIDENTIAL

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

Secretary of State for Industry

5 March 1980

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

R Langdale 12/3

Dear John.

I have seen your letter of 17 January to Geoffrey Howe, and his reply of 5 February, about the financial strains on the Export Credits Guarantee Department.

You say in your letter that there has been too much pressure on ECGD in the past to extend its commitments for particular industrial or political interests. I accept, of course, that Zambia provides a clear case of cover being extended, for political reasons, beyond the point at which it would normally have been taken. Turkey may also be a case where there have been strong political pressures, but Iran is a case of a different sort where the underlying political instability took everyone by surprise, at least to the extent that they are much more seriously affected than we.

I entirely share your concern about the potential calls upon the PSBR through defaulting creditors under the Department's guarantees. But this does present us with a genuine dilemma: on the one hand, the creditworthiness of many countries does contain some component of risk, which, since so much of the market for major capital exports lies in the developing world, must on occasion be fairly high; on the other, ECGD would not be effective as a credit insurance agency if it did not accept that taking risks was part of its essential function for British industry. The fact, therefore, that substantial claims have to be faced in these markets and elsewhere does not of itself demonstrate that ECGD's underwriting decisions were uncommercial or that ECGD was unreasonably pressed to extend cover.

My concern is that, acknowledging the elements of risk, we should not forget that ECGD exists to provide an essential service to British industry, and that the terms on which officially supported credit is provided often make a crucial difference to our companies' ability to compete overseas. It is therefore important that ECGD should continue to respond flexibly to our companies' applications for export credit insurance, taking into account, as appropriate, such factors as the importance of individual contracts to British industry and the need to compete with the export credit terms

/offered ...

offered by official export credit insurance agencies in other countries. To react to an overcautious approach would place British industry at a significant disadvantage in the fiercely competitive international market.

I know that ECGD's premiums already reflect the risks involved in different overseas markets. In principle it would seem possible, by charging appropriate premiums, to extend (or to avoid restricting) the range of markets for which cover is available, without involving ECGD in additional losses. It would be interesting to know what consideration has been given to this possibility and how ECGD's premium rate philosophy, in this respect, compares with that of other credit insurers in other countries. I am asking my officials to pursue this further with ECGD.

I am copying this letter to the Prime Minister, Peter Carrington, Geoffrey Howe, Francis Pym and Sir Robert Armstrong.

Yours ever,

Keith

-6 MAR 1980

CONFIDENTIAL

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

5 February, 1980

Dear John

Thank you for your letter of 17th January recording your concern at the financial strains from which the Export Credits Guarantee Department is suffering. I entirely share your concern - all the more so because the cost of new claims falling on ECGD represent an equivalent addition to the PSBR.

I fully agree that ECGD should be left to operate on a commercial basis to the greatest possible extent. It is clearly short-sighted to seek exports - or political advantage - by imprudent credit insurance support, as the present volume of claims payments only too clearly shows. I am sure, therefore, that, whilst doing what we sensibly can to support UK exporters, ECGD must not be pressed into extending its commitments unwisely for particular industrial or political purposes. Like you, I believe that there has been too much pressure of this kind in recent years, and hope that all our colleagues concerned will act accordingly.

Meanwhile our officials must, as you say, press on with their assessment of the prospects for ECGD's reserves. It is important that we should have a complete view about the possible implications for public expenditure and the PSBR as soon as possible.

It is worth noticing that the essential message of your letter extends more widely than the affairs of ECGD. I entirely accept, of course, the importance of effective foreign policies, for the sake of British interests and the security of the West as a whole. There are certainly some occasions on which effective leadership in the field of foreign affairs can help to promote our economic interests. Even so, the scope of the action we can take in pursuit of external policy objectives clearly has to be measured by the size of the resultant claims on our financial resources.

The Rt.Hon. John Nott, M.P.

CONFIDENTIAL

One practical implication is that Peter Carrington was plainly right in proposing that the size of the unallocated margin within next year's aid programme should be doubled. Even then, great care will be necessary to match the hopes which may be entertained for that programme with the limit on its total size. Similarly, we need to relate our policies in the military area to what we can afford.

In other words, the issues you have raised in the ECGD context have the much wider implication - that we must give consistent priority to the achievement of our economic objectives.

I am sending copies of this letter to the Prime Minister, and to Peter Carrington, Keith Joseph, Francis Pym and to Robert Armstrong.

GEOFFREY HOWE

5 FEB 1980

DEPARTMENT OF TRADE 1 VICTORIA STREET LONDON SW1H 0ET Telephone 01-215 7877

cc Pakistan Jan 1980.
Military Aid to Pakistan
Possibility of extending
ECGD cover to
Pakistan. (2)

Prime Minister

From the Secretary of State

CONFIDENTIAL

The Rt Hon Sir Geoffrey Howe QC MP
Chancellor of the Exchequer
HM Treasury
Treasury Chambers
Parliament Street
London, SW1P 3AG

17 January 1980

Dear Geoffrey.

on Pakistan Jan 80
Military Aid to
Pakistan.

You will have gathered from my reply of 14 January to Peter Carrington about aid for Pakistan that I am concerned at the financial strains falling on the Export Credits Guarantee Department. ECGD is in touch with your officials about this, and I do not want to sound alarmist; but the possible implications for public expenditure need to be noted.

There has recently been an exceptional run of defaults and payments delays in important export markets. Turkey is likely to cost ECGD a total of some £100m in claims, with little sign of her rescheduled payments being honoured at due dates. Zambia is not the only example of protracted payment delays in a market where, for political reasons, we have agreed that ECGD cover should nevertheless be maintained: claims on that market will probably total £40 m this financial year, and the same next. Iran may at best involve claims of about £160 m, of which perhaps less than half may be recovered; and, as recent papers amongst colleagues have pointed out, retaliatory economic warfare with that country could carry ECGD's total payments to some £550 m over the next three years.

CONFIDENTIAL

From the Secretary of State

CONFIDENTIAL

ECGD has of course built up reserves against just such risks; but, as with its counterparts in other countries, these have never been regarded as proof against a truly "disaster" situation. These reserves stand at some £500 m, representing about 3% of total amounts at risk; but not all of this is available as ready cash to pay exporters' claims. If the worst were to happen on Iran and if only one other major new market were to default within the next year or so (for example, neither Brazil nor Korea nor Poland are entirely free of worries, for various reasons), ECGD might well have to seek temporary borrowings from the Consolidated Fund to meet its cash commitments, for the first time since Brazil defaulted in the mid-'50s.

You will doubtless be as anxious as I am that our officials should complete their assessment of prospects with great care and make appropriate recommendations. I need hardly say that ECGD has been taking, and will vigorously continue to take, steps to reduce losses and cut costs whenever the solution lies mainly in its own hands; but I must re-iterate my belief that in recent years there has been too much pressure on ECGD to extend its commitments for particular industrial or political interests. Over-riding cases may continue to occur; but I would hope that hence forth ECGD can be left to operate on its traditional commercial basis to the greatest possible extent.

I am copying this letter to the Prime Minister, Peter Carrington, Keith Joseph, Francis Pym and Sir Robert Armstrong.

Yours ever

John.

18 JAN 1980

2 JOHN NOTT


Grey Scale #13
C
Y
M
A 1 2 3 4 5 6 M 8 9 10 11 12 13 14 15 B 17 18 19