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CABINET

DEFENCE AND OVERSEA POLICY COMMITTEE

EXPORT CREDITS FOR SOUTH AFRICA

Memorandum by the Secretary of State for Trade

Introduction

1. Senator Horwood, South African Minister of Finance, called on me on 11 October; he told me of large contracts the South Africans wished to place over the next 2-3 years, preferably (he said) in the UK, and he asked for extensive export credit facilities to cover these purchases. In particular he wants:

i) a line of credit ("macro-credit") big enough to cover the bulk of their prospective orders (say $1000 million); and, whether or not (i) is granted,

ii) terms of credit for their prospective orders less restrictive than those generally made available to South Africa by western Governments in recent years (though still within the international credit insurers' general "Consensus" on export credit terms). He claims that South Africa has had offers from other countries belonging to the Consensus equivalent to those requested.

We have to decide what reply I should give this request, which requires us to balance the advantages of increased trade with South Africa against the disadvantages of increased commitment to that country and possible adverse impact on our trade with other African countries.

2. At Annex A is a short background note on our trade with South Africa, on our investment there, and on its prospects as an export market.

Business in prospect

3. The South Africans are proposing to place an order for a power station (Tutuka). Because the project is urgent invitations to tender are to be limited to two consortia, one led by GEC, the other by a German company. The order would be worth about $320m to GEC.

4. The South Africans say they are also proposing to put out to unlimited international tender next year an order for another power station, of similar value; and other substantial business is in prospect over the next 3 years, including orders for locomotives (worth $200m), TV equipment (worth $40m) and a third power station.

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Macro-Credit

5. The South Africans say that they would like to place the bulk of these orders in the UK, and that the macro-credit would encourage them to do so. Although we have signed similar letters of credit with China and the Soviet Union, the provision of such a facility to South Africa would be unusual and, since it would not remain secret, would be resented by countries in black Africa. It must, I accept, be ruled out at least while our Rhodesian and Namibian initiatives are still at a delicate stage. Thereafter the idea might be worth re-examination if (but only if) the South Africans were in return to commit themselves to buy British.

ECGD credit for specific orders

6. If we are not to offer a macro-credit, we must consider how far the Export Credits Guarantee Department (ECGD) should offer cover for specific projects in South Africa (most immediately the Tutuka power station) and on what terms.

Level of exposure

7. ECGD's medium term commitments in South Africa amount now to £640m. Cover for the Tutuka power station alone would mean an additional commitment of £160m; and if other prospective business came our way further commitments of up to, say, £400m could be added. South Africa's political future is uncertain: there is the threat, though still probably containable for a decade or so, of internal upheaval; more immediately, pressure could easily grow for an intensification of United Nations sanctions (which it might not be in our interests to veto alone). Even if such sanctions did not directly affect the orders we are considering, they might, either by weakening the South African economy or by provoking South African retaliation, lead the South Africans to default on their very large debts to us (to British banks and investors as well as ECGD).

8. On the other hand few overseas markets are devoid of political risks; economically South Africa is still strong; and there would be no question of withholding the proposed credit from other countries with comparable economic prospects. ECGD consider, as I do, that credit cover for these valuable orders would not result in excessive exposure.

Terms of Credit

9. Under the international credit insurers' Consensus, countries of South Africa's category qualify for medium-term export credits of up to 8½ years (subject to prior notification to other credit insurers of any offer of credit of over 5 years). In 1977, as a result of UN pressure for action against South Africa, and at the then British Government's initiative, credit insurers of the Nine, and of the USA and Canada, after consultation but without formal agreement, accepted a limitation on normal export credits to South Africa to 5 years. Accordingly, since early 1978, ECGD's policy has been to restrict normal cover to 5 years, but to continue in principle to consider cover for up to 8½ years when matching terms offered by other credit insurers or when justified on strong domestic industry grounds; however, ECGD have not given credit exceeding 5 years during this period. This policy has never been spelt out in public, though EEC and North American credit insurers have been told of it. In April 1978 Mr Dell told the Commons that ECGD cover "is available for civil exports to South Africa in accordance with the Department's normal underwriting criteria"; and this is still ECGD's policy.

10. If we offer, for Tutuka and the other prospective contracts, 8½ years instead of 5 years cover, we shall, of course, be extending our exposure to the risks of a South African default described in paragraph 7. But there is another danger: we have to notify other credit insurers; and our offer may therefore become public, and lead to renewed UN demands for sanctions against South Africa and to action against our commercial interests by, say, Nigeria. It is also liable to displease some of our EEC partners and other allies (e.g. the Dutch and the Americans) who have taken a harder line on credit for South Africa than we have, and whose goodwill we need over Rhodesia and Namibia. We should, moreover, be exposing ourselves to these risks before we were sure of winning the contracts. FCO officials believe that we should need to give notice to others at governmental as well as credit insurer level; but this seems to me to court trouble unnecessarily. To offer 8½ year credit in these cases on strong domestic industry grounds (see paragraph 12) is fully consistent with the Consensus, with ECGD's stated policy (paragraph 9 above), and with our own declared policy that civil trade with South Africa should be determined by commercial considerations.

11. In my view there would be at least two advantages in our taking the initiative in offering 8½ years: the South Africans would see it as a modestly helpful gesture and might thereby be encouraged to place more of their valuable business here than otherwise; and it would minimise the risk of our losing the Tutuka order through the South Africans deciding, despite its urgency, to open it up to tenderers from, say, Japan (which has not formally accepted restrictions on credit for South Africa and which might well be ready to offer 8½ years for such a valuable contract). The question for decision is whether these advantages outweigh the dangers discussed in paragraphs 9 and 10.

The industry case

12. The Department of Industry argue that GEC is the most successful and best managed of the two UK manufacturers of large turbine generators. But UK domestic orders have been running at about 25% of the rate considered necessary to sustain a viable industry. Overseas markets are also depressed, and competition, particularly from Japan, is intense, so that GEC has been unable to make good its short-fall of domestic orders through exports. Tutuka would provide 1,000 jobs for 5 years as well as putting GEC in a strong position for the next two power stations in South Africa. Its importance may be gauged by the fact that it is broadly equivalent to the sum of turbine generator orders placed by UK Generating Boards over the last three years. Without Tutuka, there is a distinct risk of plant closures, including one at Larne in Northern Ireland.

ECGD cover for Tutuka contract

13. GEC have to finalise their bid (including financing proposals) for the Tutuka contract by mid-November. They need urgent notice of the availability and terms of ECGD cover for this contract. I support ECGD's view that, in view of the strong industry case, and subject to the required notification to other credit insurers, they should offer cover on the best consensus terms (including 8½ years).

My response to Senator Horwood

14. I also need to respond to Senator Horwood. I should like to tell him:

a) that in present circumstances and until there is a firm commitment by South Africa to place specific business in the UK up to or near the total value of the sum under discussion, I am unable to agree to the proposed macro-credit (paragraph 5);

b) that ECGD are offering full consensus cover for the Tutuka contract (paragraph 13).

15. In view, however, of the very large amount of business at stake for our exporters, I would also like to assure Senator Horwood that ECGD remain prepared to cover civil exports to South Africa in accordance with their normal underwriting criteria and within the terms of the consensus, and that, I see no reason why, other things being equal, the terms offered for Tutuka will not also be available for other similar contracts.

Recommendations

16. I invite my colleagues to agree:

a) that ECGD should offer cover for the Tutuka contract as proposed in paragraph 13; and

b) I should write to the South African Minister of Finance as proposed in paragraphs 14 and 15.

J. N.

Department of Trade
1 November 1979

ANNEX A

UK/SOUTH AFRICA TRADE AND INVESTMENT

£m

	1975	1976	1977	1978	Jan-Aug 1978	Jan-Aug 1979
UK exports to SA (fob)*	684	645	583.6	667.1	445.0	472.6
UK imports from SA (cif)*	631	612	879.7	767.7	540.6	337.0
UK% age of SA import market ∅	19.7	17.5	16.4	16.6%	-	-

* UK Overseas Trade Stats.
∅ "Foreign Trade Stats. - SA" (includes Botswana, Lesotho, Swaziland and Namibia/SW Africa).

Note: no allowance has been made for inflation.

1. The UK is currently South Africa's second most important bilateral trading partner, having lost first place, for the first time, to the USA in 1978.

2. As recently as 1974, South Africa was the UK's 10th largest export market (4th in 1965) but with successive falls in value of UK exports in '76 and '77 it declined in importance to 16th place in 1977. Despite an increase in value of UK exports of some £83 million (approx 14%) the 1978 ranking was unchanged.

3. Our market share of South African imports is also falling. After being South Africa's leading supplier until 1974, the UK is currently South Africa's second largest supplier (behind FRG). We have always provided South Africa's largest export market until last year when, with UK imports from SA having fallen by £112 million (about 13%) compared with 1977, the UK was overtaken by the US. UK imports from South Africa are predominantly raw materials (metals and minerals) precious stones (particularly diamonds) and foodstuffs.

4. UK exports to South Africa (principally machinery of all kinds, transport equipment, chemicals and related products) are partly dependent on UK direct investment in the South African private sector. The UK is the largest overseas investor in South Africa with a total investment (market value) of between four and five billion pounds, representing 51% direct foreign investment in South Africa, 24% indirect, 35% overall at end of 1977. Indications are that there is no major flow of new capital from the UK (or elsewhere) to South Africa, most new investment being financed by the retained earnings of existing investments.

5. Although South Africa is wholly dependent on imports for oil, the latter is responsible for only 25% of its energy needs, largely for transport. The inflated prices it must pay for oil are more than balanced by the foreign earnings of gold and other minerals. S. Africa has therefore a large visible trade surplus at present and offers good opportunities for British exporters.