



Weyers Box

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From the Secretary of State

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The Rt Hon Sir Geoffrey Howe QC MP
 Chancellor of the Exchequer
 H M Treasury
 Parliament Street
 London SW1

27 October 1980

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Dear Geoffrey,

DEVELOPMENT POLICY

I have read with great interest and considerable pleasure the paper attached to your letter of 2 September and the correspondence which has followed resting with Peter Carrington's reply of 20 October. I agree with a great deal of what you have to say, although I share some of the doubts which have been expressed about whether your approach is "saleable": we must have regard to the damage which might be done to our political and commercial interests if we were openly to espouse such a policy. I have therefore been giving some thought to the development of a policy, which, building on your analysis, might have some presentational attractions. I have also added some views on the trade implications of our whole approach to aid.

2 I should like to say at once that I entirely agree with you about the great diversity of interest and experience on both sides of the so-called North/South divide. I also agree that, so far as our record stands up to scrutiny, we need to give more prominence and take more credit for the immense volume of private flows which benefit developing countries, including trade and investment. Our record here is not too bad - on investment it is certainly better than most. I further agree that we need to get it across, despite much received opinion both here and in the third world, and in the multilateral aid agencies themselves, that the multilateral aid agencies are not necessarily the best way to promote development, nor indeed do they represent the massive transfer of resources which the developing countries need and seek. I particularly agree therefore that we should prepare the ground for substantial reductions in our own contributions to many of these agencies. How else can we reconcile our stated aid policy with the size of the aid budget which our public expenditure policies can tolerate?

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3 I think this is where you and I would tend to part company with Peter Carrington's paper, which would seem to be advocating more multilateral aid rather than less (and a greater concentration on the poorer countries) despite the conclusions of the Aid Policy Review. Whatever we do or say about multilateral aid - and the French have demonstrated that there can be a considerable gap between words and deeds - must be based on the premise that our own contributions must fall, so that we can make room for a higher proportion of our aid to be given in bilateral form, and concentrated in those markets and industrial sectors where there is the best prospect of it being spent to our mutual advantage. The fact that 72 per cent of our aid already goes to the poorest countries (as the FCO paper points out) as against the DAC average of 60 per cent, shows that there is plenty of scope for us to adjust our policy in this direction without becoming too conspicuous.

4 However, I do not believe it is realistic, nor presentationally feasible, to go as far as to invite all the developing countries to solve their problems by behaving like Australia, Canada, and the United States. Some countries, inevitably the poorest ones, cannot begin to attract private investment when they have to compete with the greater security and surer return from more developed countries, and the blame cannot simply be laid at the door of unstable or incompetent governments. Moreover, some of the countries which have attracted substantial flows of private capital over the past decade have also borrowed at high rates of interest, with the result that their debt burden is now a heavy drag on their development.

5 Turning to the elements of the new approach set out in paragraph 18 of your paper, items (iii), (iv), (v) and (vi) are all essentially negative, reflecting the disenchantment with multilateral aid which I share with you. They need to be balanced I think by the more positive approach to problems surrounding the OPEC surpluses which was set out in the conclusions of the paper you sent to the Prime Minister on 11 August.

6 Your final suggestion, about maintaining the open trading system, but requiring that it be applied reciprocally by the stronger developing countries also is already agreed policy, although we should discuss how we can translate this view into action. (In this context I have written separately on our approach to the renewal of the Generalised Scheme of Preferences). In the trade area of most interest to the developed countries - textiles and clothing - we have come to be regarded as one of the most hawkish on protection against low cost imports. It is the MFA which destroys our reputation and record. Our

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actual performance, however, in terms of the proportion of our market to which developing countries have access, is better than that of most developed countries and, in the realities of our present industrial situation, I do not think we can be expected to do more.

7 If we must cut back on aid, and cannot do more on trade, the only area in which we could do more in ways which could be mutually beneficial to ourselves and developing countries is by encouraging overseas investment. This is the area to which your first two points relate, but the first is largely concerned with preaching the values of a free economy to developing countries while the second is concerned largely with demonstrating that private investment is better than aid. While I agree entirely with these propositions, since private investment is more likely to go into viable opportunities, we must recognise that the underlying political attitude of developing countries, expressed through the creation of such bodies as the UN Commission on Transnational Corporations, is to argue that a nation's independence is more likely to be undermined by multinational companies: certainly there are signs that the more sophisticated developing countries recognise the reality as distinct from the political rhetoric, but the theme needs careful handling.

8 It is in this area of overseas outward investment that I would like to see us develop a more coherent policy. For, at present, there are several factors which point clearly to our national advantage. First, increased flows could help our exports by establishing or strengthening the investment presence in the more rapidly growing developing world markets, where it is becoming increasingly necessary to gain a competitive market presence. Secondly, by helping to counter the upward pressure on the exchange rate which North Sea oil is bound to exercise over the next decade or so. And, thirdly, the argument that you suggest will only stand up if we can demonstrate increased flows to countries which need them.

9 We have of course made a start by abolishing exchange control. But we should explore what more could be done. I think we should begin by studying what has happened recently to the volume and direction of United Kingdom investment overseas, and how this pattern compares with our industrial competitors. If the periods 1960/4 and 1974/8 are compared it appears that there was a fall in the proportion going to

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the developing countries and the old Commonwealth and a rise in the proportions going to the United States of America (especially) and Western Europe. In looking at ECGD's investment insurance scheme, which is not currently self-financing, we should consider whether it is attracting as much business as it should, and what might be done to make it more attractive if this seems necessary, again taking account of the policies and methods of our competitors. Another particularly valuable instrument relevant to aid policy and investment is the Commonwealth Development Corporation. I hope that the current review will lead to an increase in its ability to finance investment alongside British companies. Finally I suggest that we should look at all aspects of the tax system affecting overseas investment to ensure that no discrimination against outward investment exists and how far improvements could be made.

10 Whilst I would not suggest that it should discourage us, the traditional bias of the Opposition and Trade Unions is to oppose investment overseas which they argue is displacing investment in this country. Indeed, I could well see that some complaint from this quarter could be turned to our advantage.

11 Finally let me stress a point which you have heard before but which causes me the gravest concern as Trade Secretary. It is the industrial implications of the cutbacks on our bilateral aid programme. ECGD face a great dilemma when British companies need to safeguard their markets in countries like Tanzania where ECGD no longer feel that they ought to be giving cover - even under Section 2. There is a clear risk that export credits given in these circumstances are nothing more than aid which will be putting on ECGD a function which is incompatible with their existing objectives. I do not deny that there is a temptation to accept this changed role to some extent for support of industrially important business in substantial export markets. This temptation is all the stronger because of the cuts we have made in the whole aid field, and the business we have forgone as a result.

12 We could make up some of that lost business in other more promising markets if we were more willing to direct more of our bilateral aid to these markets and to make it go further by using more mixed credits. Our reluctance to advance minimal sums of commercial aid such as mixed credits could if carried to an extreme, force our high technology industries out of developing country markets altogether simply because they cannot compete on the aid/trade front. Can our heavy industries survive on domestic markets alone? I think not.

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13 The cost of some measures to this end need not be very large, certainly in the short term, but I am sure that if our case is to carry conviction in the international community we should need to be much more aware of its strengths and weaknesses, and be seen to be taking some steps to give the policy greater reality, notably in encouraging the markets to give attention to the less developed countries while its natural inclination will be to favour the more advanced.

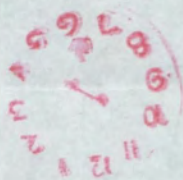
14 I am happy to go along with Peter Carrington's suggestion of a fairly informal meeting to discuss all our ideas on this subject, but I think we should need to ask officials afterwards to examine the suggestions I have made more fully, alongside yours and his, in a paper for OD. Any conclusions would however need to be within the framework of our agreed aid policy, and in particular there should be no question of planning to increase still further our commitments to multilateral aid.

15 I am sending copies of this letter to the Prime Minister and other members of OD, to Sir Keith Joseph and to Sir Robert Armstrong.

*Yours ever
JN*

JOHN NOTT

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