CONFIDENTIAL

Prime Minister

Agree to the work at X in para 9?

MCS 22/10

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

PRIME MINISTER

Yes

EXPORT CREDIT SUBSIDIES AND RISKS

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

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

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

Subsidy Costs

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

of the OECD Consensus arrangements. The arrangements are not 100 per cent proof against cheating, but we monitor closely what others - particularly the French and the Japanese - are doing, and it is important that we should continue to do so. Prior to November 1981, the going rate for many officially supported export credit contracts was 7¾ per cent, implying a heavy subsidy cost for most currencies. Increases in Consensus interest rates were agreed in November 1981 and July 1982, and interest rates have recently been falling. The result is that the agreed minimum rates for officially subsidised export credits to rich countries are now at a level (over 12 per cent) which eliminates interest rate subsidy for most currencies.

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

MLS

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

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

(i) Setting a maximum acceptable rate of subsidy in net present value terms for any individual export credit project; and a separate limit on the total subsidy level in ATP cases. The limits could not be mandatory, but would act as a trigger for special consideration (normally by Ministers) of any proposal to exceed the limits.

(ii) The hardening of export credit terms in individual cases or in particular markets or sectors should be considered where this can be achieved without undue loss of desirable business. I understand ECGD are already reviewing the options under this head.

(iii) Close monitoring of the interest rate support scheme in order to trigger a review if the gap between UK market rates and Consensus guidelines begins to widen.

Credit Risks

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

(iv) A more rigorous approach to the setting and observance of the "country limits" applicable to Section 1 (Commercial Account) and Section 2 (National Interest) operations of ECGD.

(v) More weight to be attached to considerations of country risk in considering proposals for ECGD Section 2 cover with the aim of directing support towards countries with more favourable repayment prospects.

8. I also think the following measure would be worth examining:-

(vi) Fixing a limit on ECGD's total Section 2 exposure in the riskier markets which would trigger a general review of the Department's exposure under its "national interest" operations.

Conclusions

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

Agreed ms x

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

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

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

G.H.

G.H.
19 October 1982

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