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CABINET

MINISTERIAL COMMITTEE ON ECONOMIC STRATEGY

UNITED KINGDOM TRADING POLICY AND
THE PRACTICES OF OUR COMPETITORS

Memorandum by the Secretary of State for Trade

1 We have received two reports from officials. One was the outcome of an inter-departmental study we put to them about non-tariff barriers and State aids, and how we should react to criticism from industry that our competitors play the game less fairly than we do (Annex I). The other is a note by my officials comparing how our main competitors give assistance towards securing large overseas project orders (Annex II). Since both bear on our own trading performance it is useful to consider them together.

2 The Ministerial correspondence which followed the circulation of the first paper suggests to me that there are several basic propositions on which we could all agree:-

- (i) Our national interest lies in the maintenance of the open trading system and we must not waver from it in the advocacy of our trade policy.
- (ii) Japan presents very special problems not only to us but to the United States of America and the rest of Western Europe. Her very success constitutes the biggest current threat to the free trading system. My recent visit gave me no reason to believe that her massive trade surplus will be easily or rapidly reversed. There is need for a concerted Government policy covering economic and financial as well as trade policies, most immediately for discussion at the next Foreign Affairs Council in Brussels. Officials are working on this as well as on a longer term strategy for our relations with Japan. But, once we know the outcome of the Council, I would welcome an early collective discussion and would be very happy to put in a paper drawing on the impressions from my visit.

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(iii) Our exports are currently performing well and we need to maintain the climate in which this can go on. Fundamentally, that will depend on the efforts of our exporters and the general economic conditions, including the level of competitiveness. These are of far greater importance than any administrative action by governments. Nevertheless, we need to reinforce success. That means, inter alia, keeping up the pressure, particularly within the Community, against other countries which are erecting covert restrictions or giving unfair production or export subsidies. It also means being on the alert to ensure that such financial support as we give to exports is used to best advantage. I discuss these aspects further in paragraphs 3 and 4 below.

(iv) On the import side, we should be ready to use the legitimate instruments available to us to deal with import penetration which threatens serious injury to domestic producers (eg Article XIX and anti-dumping action); and my Department played a leading role in securing revised arrangements in the Community for emergency action by Member States. The current negotiations on the Multi-Fibre Arrangement are another example like Japan where we have recognised that the normal trading rules do not by themselves produce a tolerable situation. At the more mundane level, dealt with in the notes by officials I think there is general agreement that we ought not to embark upon a systematic policy of covert protection but that our approach should be a pragmatic one. I deal in paragraph 5 below with a number of specific issues.

3 As regards our export performance, I deal first with our policy which allows support to be concentrated on energetically active firms who are either already competitive or close to being so. These policies have met with considerable success over the past 18 months, and firms are undoubtedly more confident and aggressive as a result, but we could perhaps do more. In particular:

- (a) On export credits, it is essential that Yen financing should be available to our exporters, and we should be cautious about agreeing to any further increase in Consensus rates until we are more certain of the effect of the recent increase in export credit interest rates on the competitiveness of our capital goods exporters. Unilateral increases in interest rates above those agreed under the Consensus should not be contemplated.
- (b) It is important that the full range of ECGD facilities should be maintained and that its role in the encouragement of trade should not be under-estimated.

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- (c) Recent successes have meant that the amounts available for future projects under both the Aid and Trade Provision are now negligible in both 1982/83 and 1983/84 and sums allocated under the Science and Technology Act are severely limited. Without substantial increases in both we shall fail to sustain the successes that we have so far gained and incur criticism from the growing number of firms who have responded so well to the stimulation we have given. The result is likely to be a sharp fall-back in the amount of overseas business won in the project sector.
- (d) We must also maintain the maximum commercial leverage from the existing bilateral programme.
- (e) Finally we must of course keep up the export support we provide through the BOTB and Posts overseas.

4 As regards the non-tariff barriers which our exporters encounter, I suggest that we keep up the pressure along the lines recommended in paragraphs 43-44 of the report by officials on United Kingdom Trading Policy. The need to do so is given added force by the recent indications that the new French administration has aggressive ideas for "recapturing the home market for French industry". Together with others we must continue to ensure that the Commission acts vigorously to prevent the French exporting their problems to other Member States. The Minister of Agriculture has drawn attention to a similar phenomenon on the agriculture side where the French are threatening fair conditions of competition through the use of large financial assistance to French farmers. I should also like to refer to the widespread belief that the use of DIN standards has provided German industry with a measure of covert protection. Far more important is the positive stimulus their arrangements provide for efficiency. As we agreed in MISC 14, my Department is chairing a group of senior officials which should report shortly on ways in which our own use of standards might be improved.

5 On the import side, it is clear that we must be alert to complaints from British businessmen that they are being unfairly treated while recognising that in many cases the complaint will be exaggerated or our ability to do anything about it limited and that these issues are of far less importance than general trading conditions including the sterling exchange rate. Furthermore we need to remember that widespread resort to non-tariff barriers would weaken the impact of our anti-inflation policy in the sectors concerned. It was encouraging that the NEDC discussion on non-tariff barriers in the autumn did not lead to pressure on the Government to move in the direction of covert protection. On specific issues which have been raised by colleagues I suggest we proceed as follows:-

- (i) Use of standards and certification (see above):
We should view this positively and not as a device for sheltering British manufacturers through low level standards.

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- (ii) European Investment Bank: Accept the recommendations in paragraph 42 of the report by officials.
- (iii) Use of port controls to prevent imports of products not complying with Health and Safety regulations. This will be covered in the report by officials mentioned in paragraph 4 above.
- (iv) Using References to the European Court as a means of delaying decisions by a United Kingdom Domestic Court: Accept the advice of the Lord Chancellor (Annex III).

CONCLUSION

To sum up, my recommendations would be:-

- (i) to stay broadly on our present course in attacking other people's non-tariff barriers rather than erecting our own;
- (ii) subject to that, follow up the specific points mentioned in paragraph 5 above;
- (iii) continue to give our exporters vigorous encouragement and in particular to look for ways of substantially increasing the Aid and Trade Provision.

Department of Trade
1 Victoria Street
London, SW1H 0ET

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12 February 1982

UNITED KINGDOM TRADING POLICY

Note by Officials

INTRODUCTION

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

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

GENERAL

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

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

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6. Certain other general points are also relevant -

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

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

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

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

FOLLOW-UP TO E COMMITTEE REMIT OF JUNE 1980

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

The accelerated payment of VAT on imports

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

Sperm whale oil

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

New National Safety Standards

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

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

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

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

National Type Approval Scheme for Goods Vehicles

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

THE SCOPE FOR FURTHER COVERT PROTECTION OF UNITED KINGDOM INDUSTRIES

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

14. Certain constraints bear on what can be done:

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

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

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

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

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

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

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Standards, testing and certification requirements

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

- i. The mandatory application of standards and the enforcement of national testing and certification procedures is possible under existing statutes only if this contributes to their clear purpose - road safety, consumer protection, health and safety at work. In some cases, it may of course be practicable to serve both these safety interests and those of the manufacturers.
 - ii. Depending very much on the product concerned the formulation of unique national standards and more particularly their mandatory application can add to the production costs of British manufacturers wishing to serve both home and export markets.
 - iii. Both the GATT and the Treaty of Rome outlaw the use of standards as well as associated procedures for protective purposes, although Community jurisprudence is still in a formative stage in defining the frontier, under Article 36 of the Treaty. Moreover their use could fall foul of the competition Articles of the Treaty.
16. All these considerations would have to be taken into account on a product by product basis. As will be apparent from paragraphs 10-11 above, standards writing is a slow business; moreover sizeable additional resources (both public and private) could be involved.

Port Controls

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

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

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

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

Country of Origin Markings

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

Public Purchasing

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

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

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

Animal Health

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

Industries where existing Protective Regimes have disappeared or may disappear

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

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

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

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

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

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

OTHER PROTECTIVE MEASURES

EIB Tendering Procedures

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

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

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

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

Anti-dumping

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

- i. the existence of special administrative courts, with procedures favourable to the Government, to hear certain types of action against it;
- ii. the delays inherent in legal proceedings and lack of an expedited procedure for urgent action especially in cases before administrative tribunals;
- iii. the pressure put on individuals not to pursue claims in the domestic courts;

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

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

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

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

CONCLUSIONS

General

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

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

Follow-up to E Committee

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

Scope for further covert protection

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

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

Covert measures

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

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

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

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

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

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

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

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

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

RECOMMENDATIONS

47. Ministers are invited to -

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

Cabinet Office

10 December 1981

INDUSTRIAL STRUCTURE

ANNEX II

The Japanese industrial structure is characterised by:

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

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

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

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

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

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

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

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

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

GOVERNMENT INVOLVEMENT IN INDUSTRY

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

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

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

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

EXPORT CREDIT

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

BILATERAL AID

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

MIXED CREDIT

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

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MARKET AND SECTOR PRIORITIES

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

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

Industrial Structure

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

- (a) A consistent pattern of developing policies to maintain key industries, eg nuclear, aerospace, military technology, telecommunications, fast rail, etc, with capture of markets an essential part and with concentration on no more than two companies in each industry.
 - (b) A strong Government equity stake in banking, insurance and companies themselves: a situation complicated by central controls exercised through the prefectures and through major sectors of the financial system.
 - (c) A relentless emphasis upon technology acquisition, whether through Government procurement demanding technology-transfer from non-French participants, denial of market access while French products are developed, or insistence upon joint-ventures for technologically oriented inward investment.
 - (d) Deft use of political leverage and opportunistic drive for particular markets: military sales tactics in the Middle East, South America and South Africa are one illustration. This includes the conclusion of large civil contracts with Iraq when much-needed military deliveries were being negotiated, and the large credits recently offered to Brazil when everyone else is tightening exposure to Brazil is another. A feature of French sales policy, which applies particularly but not exclusively to arms sales, is to emphasise France's independence over the continuance of supply.
- 2 Of particular interest in the projects industry are 13 consultancy firms, known as SOFRES, which are closely connected with important public sector bodies and cover the main project sectors. This public sector link allows subsidised financing, and the SOFRES admit that, wherever possible they specify French equipment. French private sector consultants also adopt a similar attitude.
- 3 Another illustration lies in Technip, largely owned by the two state-owned oil companies, and offering design engineering and general contracting for projects overseas. In 1979 they won turnkey contracts worth £103m; as with the SOFRES, post-tax profits are usually less than 1%. They have recently instituted a scheme of free engineering consultancies and claim to have gained a foothold in Brazil by doing this. It has also been reported that the Mitterand Government has it in mind to increase the French bilateral aid programme.

Government Involvement

(a) Subsidised Credit

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

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

(b) Export Credit and Insurance

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

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

(c) Aid and Mixed Credit

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

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

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

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

(d) Pre-contractual Expenses

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

(e) Ministerial Visits

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

(f) Military Aid

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

Market Sector Priorities

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

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

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

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

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

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

Industrial Structure

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

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

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

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

Government Involvement

(a) Export Credit and Insurance

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

(b) Aid

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

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

(c) Mixed Credits

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

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

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

(d) Military Aid

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

(e) DEG

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

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

Market and Sector Priorities

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

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

USA

The main characteristics of the US projects industry derive from:

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

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

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

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

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

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

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

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

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THE RT. HON. LORD HAILFORD OF ST. MARYLEBONE, C.H., F.R.S., D.C.L. 62:923

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HOUSE OF LORDS,
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Prime Minister *egstosee*

ANNEX III

United Kingdom Trading Policy

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

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

H: of S: M.

23rd December, 1981

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