2

Prime Minister

P.S.

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

6/2

5 February, 1980

Dear John

Thank you for your letter of 17th January recording your concern at the financial strains from which the Export Credits Guarantee Department is suffering. I entirely share your concern - all the more so because the cost of new claims falling on ECGD represent an equivalent addition to the PSBR.

I fully agree that ECGD should be left to operate on a commercial basis to the greatest possible extent. It is clearly short-sighted to seek exports - or political advantage - by imprudent credit insurance support, as the present volume of claims payments only too clearly shows. I am sure, therefore, that, whilst doing what we sensibly can to support UK exporters, ECGD must not be pressed into extending its commitments unwisely for particular industrial or political purposes. Like you, I believe that there has been too much pressure of this kind in recent years, and hope that all our colleagues concerned will act accordingly.

Meanwhile our officials must, as you say, press on with their assessment of the prospects for ECGD's reserves. It is important that we should have a complete view about the possible implications for public expenditure and the PSBR as soon as possible.

It is worth noticing that the essential message of your letter extends more widely than the affairs of ECGD. I entirely accept, of course, the importance of effective foreign policies, for the sake of British interests and the security of the West as a whole. There are certainly some occasions on which effective leadership in the field of foreign affairs can help to promote our economic interests. Even so, the scope of the action we can take in pursuit of external policy objectives clearly has to be measured by the size of the resultant claims on our financial resources.

The Rt.Hon. John Nott, M.P.

One practical implication is that Peter Carrington was plainly right in proposing that the size of the unallocated margin within next year's aid programme should be doubled. Even then, great care will be necessary to match the hopes which may be entertained for that programme with the limit on its total size. Similarly, we need to relate our policies in the military area to what we can afford.

In other words, the issues you have raised in the ECGD context have the much wider implication - that we must give consistent priority to the achievement of our economic objectives.

I am sending copies of this letter to the Prime Minister, and to Peter Carrington, Keith Joseph, Francis Pym and to Robert Armstrong.

Geoffrey

GEOFFREY HOWE

DEPARTMENT OF TRADE 1 VICTORIA STREET LONDON SW1H 0ET Telephone 01-215 7877

cc Pakistan Jan 1980. Military Aid to Pakistan ~~Possibility of extending~~ ECGD cover to Pakistan.

(2)

Prime Minister

AS. Rnd

From the Secretary of State

CONFIDENTIAL

The Rt Hon Sir Geoffrey Howe QC MP
Chancellor of the Exchequer
HM Treasury
Treasury Chambers
Parliament Street
London, SW1P 3AG

MO

17 January 1980

Dear Geoffrey.

You will have gathered from my reply of 14 January to Peter Carrington about aid for Pakistan that I am concerned at the financial strains falling on the Export Credits Guarantee Department. ECGD is in touch with your officials about this, and I do not want to sound alarmist; but the possible implications for public expenditure need to be noted.

on Pakistan Jan 80 Military Aid to Pakistan.

There has recently been an exceptional run of defaults and payments delays in important export markets. Turkey is likely to cost ECGD a total of some £100m in claims, with little sign of her rescheduled payments being honoured at due dates. Zambia is not the only example of protracted payment delays in a market where, for political reasons, we have agreed that ECGD cover should nevertheless be maintained: claims on that market will probably total £40 m this financial year, and the same next. Iran may at best involve claims of about £160 m, of which perhaps less than half may be recovered; and, as recent papers amongst colleagues have pointed out, retaliatory economic warfare with that country could carry ECGD's total payments to some £550 m over the next three years.

CONFIDENTIAL

From the Secretary of State

CONFIDENTIAL

ECGD has of course built up reserves against just such risks; but, as with its counterparts in other countries, these have never been regarded as proof against a truly "disaster" situation. These reserves stand at some £500 m, representing about 3% of total amounts at risk; but not all of this is available as ready cash to pay exporters' claims. If the worst were to happen on Iran and if only one other major new market were to default within the next year or so (for example, neither Brazil nor Korea nor Poland are entirely free of worries, for various reasons), ECGD might well have to seek temporary borrowings from the Consolidated Fund to meet its cash commitments, for the first time since Brazil defaulted in the mid-'50s.

You will doubtless be as anxious as I am that our officials should complete their assessment of prospects with great care and make appropriate recommendations. I need hardly say that ECGD has been taking, and will vigorously continue to take, steps to reduce losses and cut costs whenever the solution lies mainly in its own hands; but I must re-iterate my belief that in recent years there has been too much pressure on ECGD to extend its commitments for particular industrial or political interests. Over-riding cases may continue to occur; but I would hope that hence forth ECGD can be left to operate on its traditional commercial basis to the greatest possible extent.

I am copying this letter to the Prime Minister, Peter Carrington, Keith Joseph, Francis Pym and Sir Robert Armstrong.

Yours ever

John.

JOHN NOTT

18 JAN 1980

Trade

CONFIDENTIAL

DEPARTMENT OF TRADE
1 VICTORIA STREET
LONDON SW1H OET

TELEPHONE DIRECT LINE 01 215 5144
SWITCHBOARD 01 215 7877

From the
Minister for Trade

Sir Keith Joseph MP
Secretary of State for Industry
Department of Industry
Ashdown House
123 Victoria Street
London
SW1E 6RB

NBPM

24 March 1980

Dear Keith,

John Nott has asked me to reply to your letter of 5 March following his of 17 January to Geoffrey Howe about the financial strains on the Export Credits Guarantee Department.

I fully share your view about the crucial importance of ECGD's facilities, and the degree of risk-taking which underlies them, for the competitiveness of many categories of exporters; and I very much hope to continue the policy of ensuring that these facilities broadly match those available to our competitors. Nevertheless, exports which are not paid for at all, or only after protracted delays, are hardly of benefit to our economy; and, in other instances, the total cost to public funds of export support can go beyond what is sensible. It is with cases of this sort that my letter was concerned.

As you say, ECGD's premium structure reflects market risks for capital goods exports on credit terms (as distinct from the flat rate system adopted, for speed and simplicity of operations, for the great mass of exports on cash or near-cash terms). In this, it is very similar to our main competitors' systems although, because of increases in recent years due to rising losses, our premiums for capital goods exports are now fairly high by international standards.

However, unless set at levels which would patently price our goods out of the market, selectively increased premiums would not turn a bad risk into an acceptable one; and resultant losses could require further increases all round, to the detriment of our better types of business. My officials will be glad to discuss these aspects with yours. On balance, I believe that over the years ECGD's commercial judgment has enabled just about the right path to be picked between all the conflicting considerations to which you refer.

I am copying this letter to the recipients of yours.

Yours Ever,
Cecil

CECIL PARKINSON

CONFIDENTIAL

Trade

Pa. Rund

CONFIDENTIAL

MINISTRY OF DEFENCE
MAIN BUILDING WHITEHALL LONDON SW1A 2HB
Telephone 01-218 2111/3 (Direct Dialling)
01-218 9000 (Switchboard)

MO 6/13

21st March 1980

Dear John,

My Secretary of State has seen the Industry Secretary's letter of 5th March to your Secretary of State in which he comments on the role of the ECGD in support of exports. My Secretary of State's particular interest in this issue is, of course, with the export of defence equipment. My Secretary of State thinks that it is right to stress the importance of the ECGD continuing to respond flexibly to applications for export credit insurance and to avoid putting UK companies at a disadvantage by an over cautious approach.

I am copying this letter to Michael Alexander (No 10), Martin Hall (Treasury), Catherine Bell (DOI), David Wright (Cabinet Office).

Yours sincerely

J D S Dawson

J D S DAWSON
Private Secretary

J Simes Esq
Department of Trade

CONFIDENTIAL

JU

Trade

CONFIDENTIAL

DEPARTMENT OF INDUSTRY
ASHDOWN HOUSE
123 VICTORIA STREET
LONDON SW1E 6RB
TELEPHONE DIRECT LINE 01-212 3301
SWITCHBOARD 01-212 7676

Secretary of State for Industry

5 March 1980

The Rt Hon John Nott MP
Secretary of State for Trade
Department of Trade
1 Victoria Street
London SW1

Dear John,

I have seen your letter of 17 January to Geoffrey Howe, and his reply of 5 February, about the financial strains on the Export Credits Guarantee Department.

You say in your letter that there has been too much pressure on ECGD in the past to extend its commitments for particular industrial or political interests. I accept, of course, that Zambia provides a clear case of cover being extended, for political reasons, beyond the point at which it would normally have been taken. Turkey may also be a case where there have been strong political pressures, but Iran is a case of a different sort where the underlying political instability took everyone by surprise, at least to the extent that they are much more seriously affected than we.

I entirely share your concern about the potential calls upon the PSBR through defaulting creditors under the Department's guarantees. But this does present us with a genuine dilemma: on the one hand, the creditworthiness of many countries does contain some component of risk, which, since so much of the market for major capital exports lies in the developing world, must on occasion be fairly high; on the other, ECGD would not be effective as a credit insurance agency if it did not accept that taking risks was part of its essential function for British industry. The fact, therefore, that substantial claims have to be faced in these markets and elsewhere does not of itself demonstrate that ECGD's underwriting decisions were uncommercial or that ECGD was unreasonably pressed to extend cover.

My concern is that, acknowledging the elements of risk, we should not forget that ECGD exists to provide an essential service to British industry, and that the terms on which officially supported credit is provided often make a crucial difference to our companies' ability to compete overseas. It is therefore important that ECGD should continue to respond flexibly to our companies' applications for export credit insurance, taking into account, as appropriate, such factors as the importance of individual contracts to British industry and the need to compete with the export credit terms

/offered ...

offered by official export credit insurance agencies in other countries. To react to an overcautious approach would place British industry at a significant disadvantage in the fiercely competitive international market.

I know that ECGD's premiums already reflect the risks involved in different overseas markets. In principle it would seem possible, by charging appropriate premiums, to extend (or to avoid restricting) the range of markets for which cover is available, without involving ECGD in additional losses. It would be interesting to know what consideration has been given to this possibility and how ECGD's premium rate philosophy, in this respect, compares with that of other credit insurers in other countries. I am asking my officials to pursue this further with ECGD.

I am copying this letter to the Prime Minister, Peter Carrington, Geoffrey Howe, Francis Pym and Sir Robert Armstrong.

Yours ever,

Keith