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

CP/ MBJ 4/1/83

Prime Minister (2)
The Chancellor is holding a meeting to discuss this and his minute (attached). He will report the outcome to you.
MCS 23/12

From the Secretary of State

CONFIDENTIAL

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

17 December 1982

Dear Chancellor,

SUPPORT FOR CAPITAL GOODS EXPORTS

I have seen a copy of the report prepared by a working group of economists circulated to you and Mr Jenkin on 3 December. The report affects areas for which each of us has responsibility, and I think a meeting would be helpful.

I agree that export subsidies may well be an inefficient method of assisting domestic industry and commerce. But the real question posed by this latest analysis is whether it makes sense politically for the UK, with its heavy dependence on trade, unilaterally to withdraw the support we give our capital goods exporters. The alternative would be to put our weight behind multilateral action designed to reduce and, if possible, eliminate the widespread export subsidies.

The latter option is the sensible response. Present high unemployment and uncertain prospects for the recovery of world trade is no time to justify unilateral action. Indeed any multilateral move must be made with confidence that our exporters are not disadvantaged. In trade policy generally we have moved towards a more aggressive posture, refusing to see our own traders placed at a disadvantage by the protectionist moves of others. It would be inconsistent with this policy effectively to discriminate against capital goods exports by refusing to protect them against the subsidy practices, however undesirable adopted by others.

The creation of the Projects and Export Policy Division in my Department in 1980 has on many occasions been the subject of self-congratulation by the Government and has earned us well-deserved praise from industry and commerce. The success of PEP has been measured by its ability to knit together the facilities available through a variety of schemes set up for a number of different purposes and thereby to help UK firms win valuable overseas contracts.

If we are to ensure that UK exporters enjoy support comparable to that which their competitors receive, then we have to make use of such instruments as are available to us however crude they may seem to be. In the export field the international rules effectively debar us from more cost-effective approaches to beating other people's efforts to secure, with some subsidy support, market share at our industry's expense. Even in the field of credit mixte, to which the UK was a relatively late and essentially unwilling convert, we are obliged by international convention to subsidise to a far greater extent (the 25% minimum grant element) than the needs of any particular situation strictly demand.

The primary purpose of the ATP as part of the aid budget remains developmental. The industrial and commercial benefits are secondary. But for each £1 in the aid budget each benefits are several times greater than straight bilaterial aid. If one is to going to provide money by way of aid, surely it is better to provide it in a way that brings benefit back directly to the United Kingdom. If of course the real objective underlying your criticism of ATP is to reduce the size of the aid programme, that is a different matter and one which raises very wide issues.

Fixed rate interest support for capital goods exports was provided not as an instrument of industrial or employment policy. Its high cost resulted from the fact that domestic interest rates and market rates in many other countries shifted sharply out of line from the fixed rates established under the OECD Consensus. We could have obliged our potential customers overseas to pay UK market rates of interest for the privilege of buying British goods. But we would not have won many orders.

The arguments for ATP as a means of spending funds from any given size of aid budget have been given less than their due weight. Furthermore some of the arguments adduced by the group of economists against our present policy and practice are overstated. Comparision is made between the incidental but real employment benefits flowing from the provision of export assistance on the one hand, and the cost of specific employment measures on the other. This produces some figures which on the face of it are worrying, but I wonder whether the assumptions are sound and whether like is really being compared with like. Can

From the Secretary of State

we, for example, reasonably equate the sort of job provided (and probably preserved) in basically competitive sectors with the sort of job created through schemes expressly designed to keep people off the unemployment register?. We cannot ignore the fact that successful economies like Japan and Germany appear to believe that capital exports have value and that it is worth special financial measures to secure market share for them.

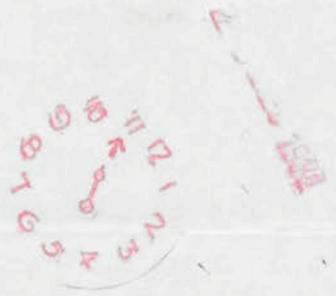
Others who have an interest in these questions and who have considered them in the past (eg. NEDC and the British Overseas Trade Board) may have views. But I am sure the right response is for us to go down the multilateral route, choosing our timing with care and watching that we do not weaken the position of our capital goods exporters in the hard struggle for overseas orders.

I am sending copies of this letter to the Prime Minister and the Secretary of State for Industry.

Yours sincerely,

PP LORD COCKFIELD

approved by the Secretary of State and signed in his absence



CONFIDENTIAL

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

JF2391
Secretary of State for Industry

11 January 1983

The Rt Hon Geoffrey Howe QC MP
Chancellor of the Exchequer
Treasury Chambers
Parliament Street
LONDON
SW1P 3AG

Prime Minister
Patrick Jenkin argues the case for export support. The Chancellor will be holding a meeting to discuss this in the next three weeks - though it has not yet been fixed - and will report the outcome.
12/1

Dear Chancellor

SUPPORT FOR CAPITAL GOODS EXPORTS

I am concerned that the report by economists, which you circulated with your minute of 13 December and on which Arthur Cockfield commented on 17 December, is so speculative that it does not present a realistic account of policy options. As it recognises, there are extremely wide margins for error in the assumptions underlying its analysis, and we need to be much surer of the likely consequences and how these will stand up to inevitable criticism by industry and Parliament if we are to change our approach.

2 The support for exports of capital goods referred to in the paper is applicable to a wide swathe of manufacturing industry: ranging from machine tools, computers, structural steel and fabrication, rail and public transportation systems, civil aviation equipment, defence sales, as well as discrete projects, and the full range of consultancy and financial services involved. Simply taking the export volume of these finished goods, and the spares and follow-on services that result from them, accounts for at least some 8% of UK exports, i.e 1.5-2% of GDP. To put this volume of manufacturing activity in jeopardy must be a high risk approach, particularly when any benefits of changing our approach held out by the report are no more than hypothetical.

3 Nor does the report recognise that export support is unique in only being paid when our companies have passed the test in the market of winning against international competitors on technology, product, price and entrepreneurial skill. It is therefore self-selecting in only being paid when our most viable

and competitive companies can beat their competitors. And it is precisely to these companies that we must look for the adoption of new technologies and processes, so that we do not lose our manufacturing capability - as has unfortunately already happened for a wide range of consumer goods - so opening the way to a new wave of import penetration when the domestic market for capital goods revives. Moreover there are a mass of sub-contractors, who rely upon British capital goods exports to establish their market.

4 The economists' concern about the particular forms of export support misses their essential character: ECGD interest make-up following directly from of our domestic interest-rate policies, and isthus entirely outside the control of companies pursuing exports. They have, indeed, with our encouragement, been strengthening their competitiveness and becoming more aggressive, and they would with some justice see any shift in policy on our part as perverse. The Aid/Trade Provision has been welcomed by industry and many Posts abroad as one of the most effective instruments to counter our competitors' soft financing techniques; but more especially it yields greater new UK exports for a given sum of aid than other elements of the Aid Programme.

5 My final point is that we are daily finding the OECD Consensus to be fallible, giving our competitors - even including the Germans and the US - opportunities to operate outside the constraints to which we scrupulously adhere. The international disciplines on mixed credit, in particular, are extremely weak. In these circumstances, unilateral disarmament in export credit matters would seem to be as objectionable as in other spheres. Rather, we should, whilst drawing full attention to the importance of strengthening international disciplines, be more aggressive in countering unfair practices by other countries. An enhanced and more flexible ATP provision would convince industry that they can pursue export business aggressively in the knowledge that where it is important to do so we can beat our competitors at their game.

6 To sum up, the report omits a full expose of the practical consequences of various options and their sensitivities. Far from reducing the assistance given to exporters, we should be ready to reinforce the support for our more successful companies. I would, however, not oppose some attempt to limit the scale of subsidy through multilateral negotiations as Arthur Cockfield has suggested. But I would be totally opposed to unilateral disarmament. That could do great harm to industry's export prospects.

7 I am sending copies of this letter to the Prime Minister, Francis Pym, Michael Heseltine, (whose defence sales interests are also closely involved), Arthur Cockfield and Sir Robert Armstrong.

Yours sincerely

David Saunders

pp PATRICK JENKIN

(Approved by the Secretary of State and signed in his absence)

11 JAN 1983