



**Regulatory Impact Assessment
on
Revisions to the Policy of the
Export Credits Guarantee Department
on Support for Foreign Content**

13 June 2007

1 Objective

To have in place a policy that simplifies the rules for the support of Foreign Content consistent with ECGD's statutory duty to facilitate UK trade business.

2 Background

- 2.1 ECGD issued a Partial Regulatory Impact Assessment (RIA) in June 2006 that accompanied its Public Consultation Document which set out three options for ECGD policy on its Foreign Content rules.
- 2.2 Within the Partial RIA, ECGD outlined areas where regulatory impacts might occur as a result of any change to its policy on support for Foreign Content, and invited comments on the associated costs and benefits of those impacts.
- 2.3 ECGD received 18 written responses to its Consultation by the end of the consultation period, 31 October 2006. Following an extension to the consultation period to 28 February 2007, ECGD received a further five responses. Two of these submissions were received after 28 February 2007 but in each case ECGD was alerted ahead of the deadline to expect a submission and has accepted them accordingly.
- 2.4 ECGD received four representations on its Partial RIA. In addition, a number of representations to the Consultation contained information which related to the impacts of any changes to its procedures.
- 2.5 None of the representations on the Partial RIA or on the Consultation attempted to quantify, other than in the broadest terms, what the impact of the options would be.

3 Options

3.1 The options proposed in the Consultation Document were:

Option 1: ECGD to retain its current policy.

Option 2: ECGD to adopt a policy based on broad “national interest” principles.

Option 3: ECGD to adopt a policy based on guideline levels of UK and Foreign Content, beyond which there would be flexibility to support more Foreign Content.

4 Responses to the Consultation

4.1 With one exception, none of the respondents to the Consultation provided any alternative proposals.

4.2 The overwhelming view of Industry, including most respondents representing small and medium-sized enterprises (SMEs), was that, while the proposed introduction of a guideline maximum of 50% Foreign Content was a step in the right direction, it did not go far enough. Industry suggested a more appropriate maximum level for Foreign Content lay between 65% and 90%. One SME representative body expressed concern over what it saw as the adverse impact on SMEs of a relaxation of ECGD’s Foreign Content rules. There were two responses from NGOs who opposed any change in ECGD’s Foreign Content rules.

4.3 The response from the Trades Union Congress (TUC) focused on the question of whether or not the changes being proposed would help the creation of manufacturing jobs in the UK. It stated that it would not oppose any decision to change the rules if needed by UK manufacturing companies to remain as competitive as possible. However, it felt that, as a general rule, an 80% maximum level of Foreign Content of a contract’s value would be high. One SME representative body which, whilst agreeing with Industry and other SME representative bodies that there should be a relaxation of ECGD’s Foreign Content rules, recommended the setting of minimum percentages of UK/SME content by sector to optimise the benefit to the UK.

- 4.4 The two NGO responses took a different stance, arguing against any liberalisation of ECGD's rules. Among other matters, these expressed concern about a possible adverse impact on small firms and the potential environmental and social impacts associated with the manufacture of supplies coming from other countries.

5 Government Response

- 5.1 In response to the needs of ECGD's customers, the Government has decided to implement a revised version of Option 3, to establish a policy with a maximum level of Foreign Content that may be supported set at 80% of the contract value. This is a response to the changes to the UK manufacturing and sourcing environment that will help to deliver a more level playing field for UK exporters with their international competitors against a background where many other export credit agencies (ECAs) are liberalising their Foreign Content rules. It could also help to make the UK a more attractive destination for inward investment.
- 5.2 Option 1 was rejected as it did not meet the needs of exporters. Further, the current rules appear to distort how UK exporters organise their production processes, causing them to operate sub-optimally and putting them at a cost disadvantage to competitors. Option 2 was rejected on the grounds that it would leave exporters uncertain as to what the rules were and could lead to inconsistency of treatment.
- 5.3 The Government believes that liberalisation and simplification of ECGD's Foreign Content rules will allow UK exporters more scope to source their supplies from the most competitive suppliers and thereby minimise their costs. This will help them to continue to compete for new business with ECGD support and so should enable more international business to be won by UK exporters in an increasingly globalised international market place. To the extent that this takes place, the benefits will be felt by the exporters concerned, their employees and shareholders, Government tax revenues and the wider economy.
- 5.4 A recent DTI report *International Trade and Investment - the Economic Rationale for Government Support (July 2006)* notes that the available evidence demonstrates that the benefits to UK prosperity from increased international trade and investment are

potentially large. These benefits, which apply to all exporters (ECGD-supported or not) and which can spread down to their domestic suppliers through disseminating best practice and to domestic competitors through heightened competition, come through a number of different channels:

- **Productivity effects:** This is partly because exporters and multinationals tend to have higher than average productivity, so that, as they expand their share of UK output, average UK productivity rises. Increased access to new ideas and technologies, and exposure to superior organisational skills, either through direct exposure to overseas markets or inward investors, or indirectly, through knowledge spillovers, can also have significant effects on the productivity of UK industry;
- **Competition effects:** Competition is stimulated by the opportunity for innovation and for high-productivity exporters to sell overseas, as this enables them to meet growth aims, reduce their dependence on a limited range of customers and strengthen their financial performance, hence allowing them to present a stronger competitive challenge in the domestic market as well; and
- **Innovation effects:** The opportunity to sell overseas promotes incentives for exporters to innovate because the rewards from successful innovation will be proportionately greater when they are able to sell into larger markets. Research and development intensity is strongly linked to business internationalisation, both through selling overseas and by foreign direct investment. Multinationals tend to have the highest research and development intensity, but only in their home country.

6 Costs and Benefits

- 6.1 The change in ECGD's Foreign Content policy should make it easier for applicants, project sponsors and banks to understand and work within that policy.

6.2 In considering potential costs and benefits, the following are not included:

- Airbus business, which accounts for a significant proportion of ECGD's portfolio, for which separate arrangements exist;
- ECGD's Overseas Investment Insurance portfolio, to which Foreign Content rules do not apply; or
- contracts under which payment is made on cash terms for which ECGD has for many years provided insurance cover for Foreign Content of up to 80% of the contract value.

No changes are being made to ECGD policy in the above areas.

6.3 There is no hard evidence on which to base an estimate of the impact of the change of ECGD's Foreign Content policy on future sourcing behaviour by UK exporters or on the levels of business that might be won by UK exporters. In addition, none of the Industry respondents suggested how much additional business they would expect to win, or how they might change their sourcing, as a result of any change. In the absence of statistical evidence or estimates from Industry, it is not possible to produce evidence-based estimates of costs or benefits.

6.4 To the extent that UK exporters win additional contracts, there would be some benefit. Although Industry respondees did not provide any statistics, their representations suggested that this could be significant and was likely to increase over time. Against this, at the margin, UK subcontractors to UK exporters could lose some business, which is currently placed with them to satisfy ECGD's requirements for UK content in the contracts it supports. Additional support for Foreign Content may also mean that foreign-owned companies based in the UK would be better placed to take future business at the expense of UK-owned companies, although access to ECGD support is not dependent upon company ownership; the statutory test is that companies, whether UK or foreign-owned, must be carrying on business in the UK. The amount of new risks that ECGD can assume will still be governed

by its risk capacity and by its policy of pricing to risk, irrespective of the source of the exports involved.

6.5 The benefits in terms of reduced administrative costs for ECGD officials in monitoring compliance with the rules are difficult to quantify, but given the relatively low number of cases, the benefit is likely to be small, probably a matter of a few thousand pounds per case. Similar benefits in the form of lower administrative costs would accrue to UK businesses than they would otherwise incur in order to comply with the more complex existing requirements.

7 Business Sectors Affected

Across all sectors of export business where ECGD supports the provision of finance (except for Airbus business), the changes to ECGD's policy would affect:

- UK exporters of capital goods and providers of project services;
- UK companies bidding for sub-contracts from UK exporters;
- UK banks administering ECGD-supported finance; and
- International (including UK-based) sponsors of major projects, who determine at the outset where goods and services will be sourced and which ECAs will be used.

8 Environmental and Social Impacts

ECGD's practice, consistent with its Business Principles, is to assess the environmental and social impacts of the exports and projects which it supports in their country of location. An NGO submission raised an issue as to whether ECGD should also consider the environmental and social impacts arising in the location from which the proposed sourcing of goods by the UK exporter is to take place, for example, the use of child labour. ECGD has supported Foreign Content for many years and the change in its Foreign Content rules does not of itself introduce a new risk in this regard, although it might, at worst, aggravate any existing risk. ECGD intends to review this during 2007/8. Subject to the outcome, ECGD would comply with Cabinet Office guidelines in its determination of the need for and/or extent of any public consultation if this review were to result in any proposed change of policy or increased regulatory burden on UK exporters.

9 Competition Assessment

ECGD provides support for companies carrying on business in the UK which export and invest overseas. This competition assessment is not intended to consider whether the changes will affect the ability of UK exporters to compete outside the UK, although the changes should help improve the position of UK exporters with possible benefits for wider competitiveness. Applicants for ECGD support include some of the UK's largest manufacturers and project managers. Given that ECGD's customers compete in world markets, it is unlikely that the changes will:

- Affect domestic market conditions in any significant way;
- Change the number or size of exporters operating in the UK in any significant way;
- Lead to higher set-up or ongoing costs for new or potential exporters that existing exporters do not have to meet; or
- Reduce the ability of exporters to choose the price, quality, range or location of their products.

10 Small Business Impact Test

ECGD supports relatively few transactions for small businesses exporting directly. However, potential UK subcontractors in the supply chain may well be small businesses. Small businesses could be adversely affected because UK main contractors would be able to source more widely from overseas and still benefit from ECGD cover. Conversely, without a relaxation of ECGD's Foreign Content rules, UK businesses may not have the opportunity to win business and thereby place sub-contracts with UK SMEs, assuming they are competitive. Most representations suggest that, in practice, if UK subcontractors are uncompetitive they will not be selected, regardless of the availability of ECGD cover. ECGD does not have any evidence to suggest that the changes would have a significant or disproportionate impact on small businesses. In the light of these representations, the introduction of minimum UK SME content determined by sector, as recommended by one SME representative organisation, would run counter to the main contractors' need to be competitive and also run counter to the Government's objective of greater simplification.

11 Enforcement and Compliance

It is proposed that the present compliance arrangements will continue. Applicants for ECGD support are expected to be able to demonstrate to ECGD that their actual sourcing reflects the sourcing approved by ECGD at the outset, if required to do so. ECGD has the ability to call on a case-by-case basis for evidence on the origin of goods and services. In addition, ECGD's Internal Audit team carries out random checks on issued cases each year; the actual level of Foreign Content is one of the areas it examines. If non-compliance is identified, then (depending on the nature of ECGD's support) a claim may be denied or the exporter may be obliged to repurchase loan drawings.

12 Monitoring and Review

Following the issue of a new HM Treasury Consent in January 2006, ECGD is required to publish in its Annual Review and Resource Accounts the amount of Foreign Content supported.

13 Summary

13.1 The Government recognises that, as technological change and more intense competition drive globalisation, there is a continuing trend towards the fragmentation and relocation of production, and for the employment of resources in line with comparative advantage so that they are used most efficiently, thus promoting growth in the world economy. In consequence, UK exporters increasingly need to source goods and services from a variety of countries in order to remain competitive. There is, therefore, a risk that to require exporters to base a large portion of their tenders on prices quoted by UK suppliers may result in UK exporters not winning business for reasons of price competitiveness or quality.

13.2 In the face of globalisation, the Government has a role to play to facilitate access to world markets so that UK companies can achieve the full potential benefits of international opportunities and thereby attract and retain high value international business. Indeed, the main role for Government is to set the framework within which businesses can respond creatively to the challenges and opportunities of a changing global environment. The issue of ECGD's Foreign Content policy should be seen in this broader

context. The Government has therefore decided that changing and simplifying ECGD's Foreign Content policy is appropriate and consistent with its policy on better regulation.

I have read the Regulatory Impact Assessment and I am satisfied that the benefits justify the cost.

Alistair Darling
Secretary of State for Trade and Industry

13 June 2007