

MINUTES OF MEETING HELD 19 NOVEMBER 2003

Present: Ms Liz Airey (Chairman)
Professor Jonathan Kydd
Mr Martin Roberts
Mr John Elkington
Mr David McLachlan
Mr Tony Shepherd

In Attendance: Mr Vivian Brown
Mr Victor Lunn-Rockliffe
Mr John Weiss
Mr John Ormerod
Mr Ian Dickson
Mr David Allwood
Mr Filip Wuebbeler

Mr Gareth Waterhouse (Secretary)

1 APOLOGIES FOR ABSENCE

Apologies were received from Mr Armitt, Professor Phylaktis, Sir Stephen Brown and Dr Thamotheram.

2 MINUTES OF THE PREVIOUS MEETING

It was agreed that the minutes of the meeting held on 17 September 2003 needed a number of revisions, and these would be approved subsequent to the meeting.

Matters Arising

2.1 Recruitment of new Chair and Chief Executive

2.1.1 Interview boards had now been held for both positions. The Chair would be appointed by the Secretary of State and an announcement was anticipated in

December. The Chief Executive was appointed by the Civil Service and would require central approval, but it was hoped that the name would be announced before Christmas.

2.1.2 All of the shortlisted candidates were from the private sector, with most having a background in financial services.

2.2 EGAC Membership

2.2.1 This would be the final meeting for David McLachlan. The Chair thanked him for his valuable input, and for his long service on the Council.

2.2.2 The Secretary of State had asked John Elkington and Professor Jonathan Kydd to extend their terms for a further two years. Both had agreed to this.

2.2.3 There may be changes to the membership, role and remit of the Council going forward, but these would await the arrival of the new Chair and Chief Executive.

3 THE EXTERNAL ENVIRONMENT PROJECT

3.1 Mr Ormerod introduced the presentation, making the following points:

3.1.1 The project had been established in response to the changing shape of UK industry. Although ECGD had a methodology for forecasting business and future income, this project looked at the whole of the external environment and considered the future of the UK capital goods market.

- 3.1.2 The technique employed was known as Varieties of Capitalism analysis, and involved looking at the underlying institutional and organisational factors that determined the development of industry.
- 3.1.3 Presentations had already been given to HM Treasury, DTI and ECGD's own Senior Management Team. The consensus had been that the work was impressive and valuable when considering the future.
- 3.2 Mr Wuebbeler gave a PowerPoint presentation, making the following main points:
- 3.2.1 The project was split into three components. The first component, which looked at the supply of capital goods from the UK, was in three parts: Report 1A was the Varieties of Capitalism analysis, and would form the bulk of this presentation; 1B analysed specific industry sectors; and Report 1C considered demand for these goods from emerging markets (as well as competition in their production). The second component would analyse the private sector provision of export credit support. The final element of the project was then a strategy paper outlining ways forward.
- 3.2.2 The first section of Report 1A was an overview of the current economic situation and clear future trends. This showed that the UK was at the forefront of becoming a service-based economy, and that changes in capital goods manufacturing meant that production in the UK would only be viable if firms moved up the value chain to produce products that were customised and competed on quality (i.e. high value-added manufacturing).
- 3.2.3 The Varieties of Capitalism (VoC) analysis looked at three elements of the institutional environment relevant to capital goods exporters. The VoC

methodology sought to explain differing economic performance of firms and markets in different countries by comparing their respective institutional frameworks.

- 3.2.4 The analysis concluded that the industrial relations system, skills formation mechanisms and the corporate governance framework of the UK all failed to encourage high value-added manufacturing. Further, there was complementarity between these institutions so that they reinforced one another. It would thus be difficult, and extremely costly, to change the environment towards one favouring the capital goods sector.
- 3.2.5 Given this environment, it was likely that demand for ECGD's services would be at best stagnant, in the medium term. It was likely that demand would come from a limited number of successful exporters.
- 3.2.6 Report 1B first considered broad sectoral issues. For a number of reasons, including some detailed in the VoC analysis, the UK was systematically disadvantaged in forming business clusters that were important for developing products and skills needed for high value-added manufacturing. Although staying out of the Euro was currently a rational decision, it was possible that the decision may harm the competitiveness of UK exporters in the longer term.
- 3.2.7 Looking at specific industries, it was concluded that demand was likely to be stable in the defence and oil and gas sectors. It was possible that demand for ECGD services from aerospace customers would rise. However, there were no other sectors that appeared to be growing, and the UK was not likely to be a major producer of capital goods in new industries (for example renewables).

- 3.3 In discussion, the following points were made:
- 3.3.1 It would be important to complete the rest of the project to gain a full picture of future demand, including the markets where business would be done and the behaviour of the private sector. The conclusions could then be used to consider the inward looking question of the appropriate size and shape for ECGD. Presentations were also being given to other government departments for them to consider the implications as part of their policy thinking.
- 3.3.2 One Council member endorsed the approach taken and said that he used Varieties of Capitalism analysis in his own work. He agreed with the overall conclusions, including the complementarity that had been created between the institutions in the UK. He also said that large multinational firms perceived this situation, and hence globalisation was not causing a convergence.
- 3.3.3 However, he felt that there would be some exceptions to the assertion that capital goods industries required only incremental innovation. If this proved to be the case, then the flexible labour market in the UK would also allow workers to transfer their general skills into this industry and it would be a success. Often, though, as was the case with the nuclear industry, the state would have to underpin development work.
- 3.3.4 Other Council members also agreed with the conclusions, but felt that the stability of the system would be disrupted by some future changes, a specific example being harmonisation caused by the EU.

- 3.3.5 It was agreed that an important implication of the work was to develop new products to suit the small range of customers. This would help to gain extra business at the margins of current activities.
- 3.3.6 One Council member said that the analysis was excellent, and exactly reflected his experience of the industry.
- 3.3.7 Given that the implications seemed to be a reduction in demand for ECGD support, it was questioned whether it would be valuable to gain economies of scale through creation of a European ECA. Mr Brown responded that ECGD could still add value, for example being involved at the outset of a project with the sponsors could help steer business to the UK. The conclusions of the report did indicate that there would be some British firms who would perform well and still require cover. It was also argued that comparative differences between countries were an advantage for Europe as a whole.
- 3.3.8 It was agreed that there were significant risks in being dependent on a small number of customers, particularly if they were to change their strategic direction.
- 3.4 The Chairman thanked Mr Wuebbeler for his presentation, and said that the Council looked forward to an update on this work in the future.

4 DOING BUSINESS IN IRAQ

- 4.1 Mr Ormerod said that a product was being developed that would allow short-term cover on repayments from the Trade Bank of Iraq. Medium term and Oil products had been judged to be too risky.

- 4.2 This would allow the Coalition Provisional Authority to purchase capital equipment and consumer goods to be paid for from receipts of Iraqi oil channelled through the Iraqi Development Fund. ECAs would cover the liquidity (or timing) risk that proceeds would not exactly match the repayments.
- 4.3 HM Treasury had rejected the initial proposition, as they were concerned about the transition to an Iraqi Administration. There were also issues regarding the legal position of an agreement with the CPA.
- 4.4 Ministers had now escalated the debate, and were awaiting a response from Treasury. A signing ceremony had already been organised by other ECAs in Rome, and it would thus be necessary to resolve the issue by 5 December.
- 4.5 There was currently no real push from customers, but it was important to have something in place before the second tranche of contracts were awarded.

5 REVIEW OF THE OECD COMMON APPROACHES – EGAC(03)26

5.1 The Minister had asked for the Council's urgent advice on this issue. Mr Allwood presented the paper, explaining the major revisions to the Recommendation:

- The 2001 agreement had excluded the USA and Turkey, but all countries would now adopt the standards.

- The assessment process would be applied to both the exported goods and the overseas project. This brought other countries in line with the standards that ECGD had been applying.
- All projects in sensitive areas now had to be reviewed – there was previously a threshold of SDR10m. In practice, this would mean that all projects would need to be screened, as it would be necessary to establish if each was in a sensitive area.
- There had been clarification of the standards required for projects, including where there were differences between local and international requirements.
- It was now required that EIAs were made publicly available (normally by the project sponsor) for at least 30 days prior to the commitment to offer support. This move went further than ECGD's current policy.

5.2 In discussion, the following points were made:

5.2.1 It would be for the project sponsors to make the EIAs public, although this may vary in some countries.

5.2.2 The OECD Export Credit Group policed these policies, using an annual reporting mechanism from the individual ECAs.

5.2.3 The next review would be in 2006, and it was envisaged that this would be a more radical overhaul of the Recommendation.

5.2.4 Mr Allwood said that he had given a presentation at the Customer Seminar, and shared the draft with BEXA and a number of NGOs. BEXA had

accepted the changes, but one NGO respondent felt they did not go far enough. He believed that they appreciated the opportunity to comment.

5.2.5 The Council agreed that ECGD should accept the revised version. As it stood, other countries would be brought closer to ECGD standards. To reject it would risk losing this progress. However, where ECGD went further than required in the new standards, it was felt that the current position should be maintained.

5.3 The Chairman congratulated Mr Allwood on the incremental improvements, and agreed that a letter should be sent to the Minister For Trade informing him of the EGAC decision after the meeting.

6 BPU SIX-MONTHLY REPORT – EGAC(03)24

6.1 The report was given to the Council for information, but some questions arose.

6.2 Mr Allwood was asked if corruption issues were now being incorporated in the remit of the BPU. He replied that this remained part of the Business Group's responsibility but that he had been involved in recent internal discussions.

6.3 Mr Weiss said that the Minister for Trade had asked ECGD to consider enhancements to their procedures, following accusations and press coverage of customers. Recommendations had now been drawn up, including some based on suggestions made by the Minister.

6.4 Mr Ormerod said that this issue was also now being raised at the OECD since negotiations on the environment had been concluded.

6.5 The Chairman said that that the Council should have picked these points up when the matter was discussed at the previous meeting. It was agreed that an agenda item on corruption should be scheduled for the January meeting, to cover the new procedures and the negotiating brief for the OECD discussions.

7 GUARANTEES ISSUED – EGAC(03)25

7.1 Mr Allwood noted that there were a number of cases in Iran coming through. These were mostly small cases, and the Iranian rules were similar to the World Bank standards, so there were few concerns.

8 ANY OTHER BUSINESS

8.1 Future Meetings

8.1.1 The topics for discussion at the January meeting were agreed to be:

- Corruption
- An update on the APM Programme as pilot work had now been completed.
- The BTC Pipeline (if ECGD had completed its consideration of the case)

8.1.2 Next year's meetings would again take place on the third Wednesday, every other month.

8.2 Customer Christmas Reception

8.2.1 Mr Weiss invited Council members to attend on Friday 12 December. This would be another opportunity to speak to banks and customers.

GARETH WATERHOUSE

EGAC Secretariat