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Response to Consultation on ECGD Support for Foreign Content

1. Summary

This submission is made by four non-governmental organisations – The Corner House (UK), WWF (UK), FERN (Belgium), Both Ends (The Netherlands) and Campagna per La Riforma della Banca Mondiale (Italy), hereafter the “five consultees” – who welcome the opportunity to comment on the ECGD’s “Consultation on ECGD Support for Foreign Content”.

Currently, the ECGD will support export contracts only where the value of the goods and services sourced from abroad but not processed further in the UK¹ – defined as “foreign content”² – does not exceed 30-40 per cent of the total contract value.³ However, the Department’s major customers – all multinationals, many of which are foreign-owned⁴ – have expressed the view that that the ECGD’s current policy is adversely affecting the ability of UK exporters to secure business.⁵

In responses, ECGD has proposed that the rules regulating foreign content should be relaxed, allowing for a greater percentage of the goods and services in contracts supported by ECGD to be sourced from outside the UK. Under the proposed new rules, ECGD would be permitted to support non-UK-sourced goods and services up to 50 per cent of the contract value.

The five consultees support the sustainable development of environmentally-sound manufacturing capacity in the South and recognises that greater ECGD support for foreign and local⁶ content, if conditioned on “best practice” sustainable development standards, could assist in building that capacity. Ensuring that any

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1. Goods and components that are imported into the UK and that undergo further industrial processing “may be regarded as being produced or manufactured in the UK” (Consultation document, p.6, para 19).
 2. The consultation document defines foreign content as “the cost to the UK exporter of foreign goods and services included in its export contract” (Consultation document, p.3, para 5).
 3. For contracts over £10 million, the limit is set at 30 per cent of the contract value; for contracts under £10 million, at 40 per cent (Consultation document, p.9, paras 36 and 37).
 4. The Consultation document lists the ECGD’s 10 top exporter customers as: Airbus SAS, Rolls Royce plc, BAE Systems (operations) Ltd, VWS Westgarth Ltd., VAI Industries (UK) Ltd, Mabey & Johnson Ltd, Semcorp Simon-Carves Ltd, M. W. Kellogg Ltd, RWE Thames Water Plc and Motorola Ltd. The top 10 banking customers are listed as: Barclays Bank PLC, BNP Paribas, Bank of Scotland, Calyon, Deutsche Bank AG, Citibank International plc, HSBC Bank plc, Citibank NA, ABN Amro Bank NV and Societe Generale. ECGD also notes (p.14) that sounding had been taken from customers represented by the British Exporters Association (BEXA), British Consultants and Construction Bureau (BCCB), British Chemical Engineering Contractors Association (BCECA), British Bankers Association (BBA) and the Confederation of British Industry (CBI).
 5. The Consultation document does not reveal the identity of those companies that made representations.
 6. Local content is defined as “the cost to the UK exporter of goods and services from the buyer’s country that are necessary for executing, and which form part of, the UK export contract” (Consultation document, p.6, para 20.4). In the renewable energy sector, for example, local content in wind projects may be in the order of 25-70 per cent (Erik Sejersen, Vetras Wind Systems, Presentation to UNEP/ECA Seminar, Vienna, 2006). The five consultees recognise that the percentage of local content is limited by OECD rules, consideration of which is beyond the remit of the current consultation.

foreign suppliers that benefit from ECGD's subsidies⁷ comply with the UK international human rights, labour rights and environmental obligations should form a key element of such standards.

However, the proposed changes to the ECGD's foreign content rules:

- Are premised on the unsubstantiated (and in the view of the five consultees, erroneous) assessment that changes to the current policy will have no environmental or social impacts;
- Would permit foreign content to be supported without adequate screening of the environmental and labour impacts of the manufacturing practices used by suppliers;
- Rely on what the ECGD itself acknowledges to be a speculative assessment of the potential impact on UK jobs, which could prove far greater than anticipated by ECGD;
- Would unfairly and unjustifiably privilege multinational companies over the UK's small and medium sized exporters; and
- Are likely to lead to growth of offshore-registered applicants and foreign suppliers / subcontractors with as yet unquantified impacts for the UK Exchequer.

In response to the ECGD's question (para 4.1) as to whether or not the ECGD should "change its current policy for supporting foreign content under credit contracts", the five consultees recommend that:

- No changes to the percentages of foreign content currently permitted should be made in the absence of accompanying human rights, labour rights and environmental safeguards with respect to the activities of the foreign suppliers;
- The ECGD makes public the evidential basis for its conclusion that the proposed new rules would have no environmental or social impacts;
- The consultation period be extended to allow comment on the above assessment, which should include a review of the environmental, labour and human rights practices of foreign suppliers supported by the ECGD since the introduction of the Department's case impact assessment procedures;
- The current ECGD case impact assessment procedures should be amended to include questions about the *environmental* impacts of the manufacturing processes used to produce any goods that will be included in the applicant's export contract;
- The ECGD's Application forms should be amended to include Question 8 of the Impact Questionnaire, specifically those clauses relating to the use of *child, bonded or forced labour* by suppliers;
- ECGD should explain how it will monitor the environmental and social impacts at the project level arising from the increased use of foreign content.
- Prior to coming to any decision on the proposed new rules, ECGD should undertake further research in order to quantify the potential impacts on jobs amongst small- and medium-sized UK subcontractors and make the results available for comment;
- The ECGD should make public its views as to how a decision that it recognises may adversely affect smaller UK exporters whilst benefiting larger multinationals would be compatible with its duties under the 1991 Export and Investment Guarantees Act.
- ECGD should publish an analysis of the expected lost revenues to the UK Exchequer following any increase in the limit on foreign content.

7. The UK Government has assessed the annual subsidy to ECGD at £150 million, equivalent to the capital cost of building three hospitals in the UK or the annual subsidy currently paid to maintain Britain's rural post offices (<http://news.bbc.co.uk/1/hi/uk/6061172.stm>).

2. Environmental and Social Impacts of Supplier's Manufacturing Processes

In the two decades since ECGD's current foreign content rules were introduced, there has been an exodus of manufacturing jobs from the UK and increasingly of service jobs, indicated by the rise in "offshoring" in the IT, banking and other service industries. A December 2004 report by the manufacturing employers' organisation, EEF, based on a survey of 494 member companies, found that "almost half of all manufacturers surveyed predicted that more of their production would take place outside the UK over the next five years."⁸ Moreover, around 30 per cent of those not currently outsourcing anticipated that "some production would be located offshore in the future. Aggregate data on the numbers of jobs involved are not available, although trade unions claim that a significant proportion of the 300,000 jobs lost in the UK's manufacturing sector over the past five years are due to the effects of relocation."⁹ ECGD cites Eastern Europe, Singapore and China as the main destinations to which UK manufacturing is moving.¹⁰

In many instances, the export of manufacturing has been driven not simply by the removal of capital controls, but also by host government incentives in the form of lower environmental standards, tax exemptions and lower labour standards, often encouraged as part of IMF and World Bank structural adjustment programmes.¹¹ A 1993 survey of 10,000 large- and medium-sized German companies, for example, found that one in three intended to transfer part of their production to Eastern Europe or Asia, because of lower wages and laxer environmental standards.¹² The resulting development impacts can be severe. Where exemptions are given for environmental laws, pollution can exacerbate poverty and lead to widespread environmental degradation. The advantageous tax holidays and other agreements won by multinationals can also deny emerging market and developing countries considerable income. Russia's national Audit Chamber, for example, estimates that the production sharing agreements negotiated with Shell for its Sakhalin 2 oil and gas project have already cost the Russian state \$2.5 billion.¹³

The available evidence does not support arguments that the export of manufacturing by UK and other multinationals leads to a "raising of standards" in the South. Where standards have been raised, they have often been achieved in the face of opposition from such companies, which, in many cases, have actively sought and obtained exemptions from local environmental regulations they deem too stringent.¹⁴ Most recently, multinationals have been lobbying to oppose proposals by the Chinese Government to adopt a new law that would crack down on sweatshops and protect workers' rights.¹⁵

There is thus a high risk that relaxation of the ECGD's foreign content rules will lead to exporters placing contracts with manufacturers who operate to lower environmental and social standards than those in the UK, with the likelihood of resulting adverse environmental and social impacts. As ECGD itself acknowledges, "all businesses normally try to operate on the basis of 'least cost' sourcing for maximum efficiency".¹⁶ Indeed, the ECGD's major clients have made it clear that, were the rules to be relaxed, greater use of foreign manufacturers would result, since "it is increasingly difficult to source goods and services from the UK at levels that the current policy requires".¹⁷

In light of the above concerns, the ECGD's conclusion (for which it fails to offer any substantiation) that the new proposals will have no environmental or social consequences lack credibility. Moreover,

8. EEF, 'Where now for manufacturing?', <http://www.eef.org.uk/UK/publications/policy/public/publication17122004.htm>

9. www.eurofound.eu.int/2005/11/word/uk0508103s.doc.

10. Consultation document, p.8, para 34.1.

11. In the case of Guyana, environmental staff at the World Bank opposed the "overgenerous terms" given to mining and logging companies, insisting that "sustainable development" can be achieved only if Guyana secures greater benefits from existing concessions. The Bank's macroeconomists, however, whose goal is to promote "sustained growth", rejected the proposition out of hand as it would "send the wrong signals" to potential foreign investors. See Colchester, M, *Guyana: Fragile Frontier - Loggers, Miners and Forest Peoples*, Latin America Bureau / World Rainforest Movement / Ian Randle Publishers, London, 1997.

12. "Can labour compete?" *The Financial Times*, 7 March 1994. See also "Labour price falls offshore", *The Financial Times*, 25 February 1994.

13. See *Associated Press*, 10 February 2005, 'State Audit Chamber accuses Shell consortium of overspending'

14. For example, oil multinational BP negotiated a special legal regime for its recent Baku-Tbilisi-Ceyhan oil pipeline, under which it was exempted from all local social and environmental legislation. See Hildyard, N. and Muttitt, G., "Turbo-Charging Investor Sovereignty: Investment Agreements and Corporate Colonialism," in *Destroy and Profit: Wars, Disasters and Corporations. Focus on the Global South* (www.focusweb.org/pdf/Reconstruction-Dossier.pdf).

15. Barbopza, D. "China drafts law to empower unions and end labor abuse", *New York Times*, 13 October 2006.

16. Consultation document, p.55, para 32: "All businesses normally try to operate on the basis of 'least cost' sourcing for maximum efficiency. ECGD's current foreign content policy is a constraint on the ability of UK exporters to operate in this way. Options for change that would lessen this constraint will improve the business efficiency of ECGD's customers."

17. Consultation document, p.54, paras 26-26.1: "Certain of ECGD's customers and trade associations have signalled that they would welcome a change to the policy. They assert that . . . it is increasingly difficult to source goods and services from the UK at the levels that the current policy requires."

in failing to provide evidence to back its claim, the ECGD's consultation document falls short of the requirements of the Government's guidelines for a Regulatory Impact Assessment, namely that:

- “Costs and benefits **must be quantified** wherever possible” (italics in original);¹⁸
- “Indirect costs” should be assessed;¹⁹
- The assumptions made in assessing risks should be clearly stated.²⁰

The five consultees believe that the ECGD has access to the data needed to quantify the environmental and social impacts of its proposal and therefore sees no reasons why it has not done so. Likewise, there would appear to be no reasonable grounds for the ECGD failing to spell out the assumptions it made in reaching its “no impact” conclusion with regard to the environmental and social risks of the proposed changes.

The five consultees therefore recommend that:

- The ECGD makes public the evidential basis for its conclusion that the new rules would have no environmental or social impacts;
- The consultation period be extended to allow comment on the above assessment, which should include a review of the environmental, labour and human rights practices of foreign suppliers supported by the ECGD since the introduction of the Department's case impact assessment procedures;
- No changes should be made to relax the current foreign content rules until the above have been completed.

3. Inadequate Screening of Compliance of foreign suppliers' manufacturing processes with ECGD's Business Principles and other policies

It is ECGD policy “to ensure that all cases supported by ECGD are compatible with its Statement of Business Principles”.²¹ In particular, a decision on ECGD support *must* take into account “the Government's international policies, including those on sustainable development, environment, good governance and trade.”²²

Significantly, the ECGD does not restrict the application of these policies solely to the projects for which exports are intended or to the direct and indirect impacts of the exports themselves. In considering the compliance of credits and guarantees with the core labour standards to which ECGD is committed,²³ for example, the ECGD takes a broad view, which encompasses the supply chain. It requires that applicants provide information on whether the goods or services to be supported will “cause”, “require”, “bring about” or “stimulate” forced or bonded labour or harmful child labour. Applicants are specifically referred to the International Finance Corporation's “Good Practice Note” entitled *Addressing Child Labour in the Workplace and the Supply Chain* (emphasis added), which the ECGD states it uses as a benchmark for projects involving child labour.

18. Cabinet Office, Regulatory Impact Assessment Guidelines,

http://www.cabinetoffice.gov.uk/regulation/ria/ria_guidance/costs_and_benefits/quantification.asp.

19. Cabinet Office, Regulatory Impact Assessment Guidelines,

http://www.cabinetoffice.gov.uk/regulation/ria/ria_guidance/costs_and_benefits/analysing_costs.asp. The Guidelines state: “Don't forget any indirect costs.”

20. Cabinet Office, Regulatory Assessment Guidelines, Testing Assumption,

http://www.cabinetoffice.gov.uk/regulation/ria/ria_guidance/costs_and_benefits/testing_assumptions.asp

21. Business Principles Unit, “Case Impact Analysis Process”, ECGD, May 2004, p.1,

http://www.ecgd.gov.uk/index/pi_home/case_impact_analysis_process.htm. The Business Principles summarise ECGD's policies on “ECGD in Business”, “Sustainable development and human rights”, “developing countries”, “business integrity” and “transparency”.

22. ECGD, “Statement of ECGD's Business Principles”, in “ECGD's Business Principles”,

http://www.ecgd.gov.uk/index/pubs_home/pr_bp.htm: “We will promote a responsible approach to business and will ensure our activities take into account the Government's international policies, including those on sustainable development, environment, human rights, good governance and trade.”

23. It is ECGD's policy not to provide support to projects that involve harmful child labour or forced or bonded labour. The ECGD also expects compliance with six core UN human rights conventions and eight ILO fundamental conventions. .

In practice, however:

- The ECGD's assessment²⁴ of environmental impacts is restricted to the impacts of the *projects* for which the goods supplied are intended,²⁵ and the impacts of the *goods* themselves.²⁶ None of the application forms that exporters are required to complete contains a single question relating to the impacts of **the manufacturing processes used by contracted suppliers**. Such questions are also absent in the more detailed Impact Questionnaire that applicants must complete for Medium and High Impact cases. The ECGD is therefore not in a position to assess whether the goods it supports – rather than the projects where they will be used – have been manufactured in accordance with the standards and policies to which ECGD is committed.
- Although Question 8 in the ECGD's Impact Questionnaire seeks information related to the use of child labour and of bonded and forced labour,²⁷ this question is not included in any of the application forms that exporters must complete. **No assessment of the use of child labour or slave labour is thus conducted in cases categorised as having "Low Impact" since applicants are not required to fill in the Impact Questionnaire, which is only used for Medium and High Impact cases.**²⁸
- In reinsurances cases, the impact assessment and environmental screening is not undertaken by ECGD. Many reinsuring Export Credit Agencies (ECAs) do not assess labour rights issues – and the use of child or bonded or forced labour by suppliers of goods supported by ECGD would not therefore be picked up.

Such omissions raise doubts over the ECGD's assertion that **any environmental and social impacts attendant on greater use of foreign content** "will be addressed in accordance with ECGD's Business Principles."²⁹

The five consultees therefore recommend that:

- The ECGD's Application forms should be amended to include questions about the environmental impacts of the manufacturing processes used to produce any goods that will be included in the applicants export contract
- The ECGD's Application forms should be amended to include Question 8 of the Impact Questionnaire, specifically those sub clauses relating to the use of child, bonded or forced labour.

4. Monitoring impacts at the project level

Increasing the proportion of foreign subcontractors will further increase the need for monitoring of implementation of environmental standards by its clients. For example, ECGD is currently considering the Sakhalin II oil and gas project. The applicant is a Bermudan registered company, Sakhalin Energy

24. The assessment procedures are set out in ECGD Case Analysis Process, http://www.ecgd.gov.uk/home/ps_home/new_application_forms.htm. All applicants must complete the impact questions contained within ECGD's standard application forms for all civil, non-aerospace cases. These request information on all the likely direct impacts of the goods and services being exported, the location of the project and a description of the current and future activities at this site. On the basis of the responses given in the application forms, ECGD conducts an initial review to identify potentially significant impacts and to determine responsibility for case assessments. The ECGD's Business Principles Unit then completes a Case Impact Screening form, on the basis of which each application is assigned a potential impact level of "Low", "Medium" or "High". Projects classed as "low impact" will not normally be scrutinised further. Applicants will not therefore be required to complete a full environmental impact questionnaire.

25. The impact questions contained within ECGD's standard application forms request information on all the likely direct impacts of the goods and services being exported, the location of the project, and a description of the current and future activities at this site. ECGD customarily defines the "project" as the activities at the site at which the exported goods and services are to be used. When the exported goods are replacement components for an existing operation, the "project" comprises all the activities taking place within the site boundary of those existing operations. For expansions and greenfield projects, the "project" includes the current uses of the site as well as the new uses resulting from the implementation of the project, plus any associated infrastructure developments leading to the site. The latest versions of the application forms are available on the ECGD website: http://www.ecgd.gov.uk/home/ps_home/new_application_forms.htm.

26. For example, with respect to the "actual or potential impacts of the goods/services/Investment", applicants are asked to "identify all areas of impact and provide sufficient information for ECGD to determine whether or not impacts resulting from normal operations or reasonably predictable consequences of misuse or breakdown of equipment are significant."

27. Impact Questionnaire, Question 8, http://www.ecgd.gov.uk/home/ps_home/new_application_forms.htm: "Will the goods or project cause, require, bring about or stimulate any of the following . . . child labour . . . bonded or forced labour?"

28. Case Impact Analysis Process, paras 6.2 and 6.3.

29. Consultation document, p.56, paras 39 and 40.

Investment Company. Only 5% of the whole project is being completed by UK based contractors.³⁰ Much of the construction has been completed using lower cost Russian labour. Yet the project has been beset by problems relating to meeting environmental standards. Specifically, the techniques for crossing rivers with 800 km pipelines have not followed the environmental management plan. Local and International NGOs have raised concerns and published reports of independent monitoring trips, which have exposed these problems. Without this public pressure ECGD would not have been aware of the extent or seriousness of the issues.

ECGD has since been involved in site visits to assess the river crossings, which have confirmed that problems exist. Sakhalin Energy has indicated that these problems stem from failure to control subcontractors. ECGD does not have any procedures or adequate capacity to monitor the performance of subcontractors on the range of projects it supports. It is not acceptable for ECGD to rely on NGO monitoring to expose bad practices. Without a systematic process to monitor implementation of environmental and social management plans, ECGD should not increase its exposure to greater use of subcontractors.

The five consultees recommend:

- ECGD should explain how it will monitor the environmental and social impacts at the project level arising from the increased use of foreign content.

5. Inadequate Assessment of Impacts on Small- and Medium-Sized Exporters

As noted (Section 2), the ECGD's major clients have made it clear that they would use the new rules to source more goods and services from abroad, since they deem many UK suppliers to be uncompetitive.

The ECGD notes that this could lead to some UK sub-contractors losing some business but states that "the size of these costs is a matter of speculation".

The five consultees recognise the difficulties in assessing the potential loss of jobs in the UK but believes that speculation is not a sound basis on which to take a decision.

The five consultees recommend that:

- ECGD should undertake further research in order to quantify the potential impacts on jobs amongst small- and medium-sized UK subcontractors.

6. Privileging UK-based Multinationals over UK Subcontractors

The proposed changes, if adopted, would lead to a significant reallocation of the ECGD's subsidy away from UK sub-contractors towards foreign suppliers, to the advantage primarily of UK-based multinationals. The ECGD accepts that small UK businesses may be adversely affected "because the main contractors will be able to source more widely from overseas and still benefit from ECGD cover".³¹ The new procedures would also significantly weaken the bargaining power of UK sub-contractors when negotiating contracts with UK multinationals, since they will be in a stronger position to threaten to seek ECGD-supported supplies from abroad.

The five consultees note that the ECGD itself accepts that there is "no hard evidence"³² to support the case made by the exporters for changing the foreign content rules. The ECGD also states that the proposed changes would likely have a marginal influence on whether or not its clients win or lose and export contract.³³

30. Mathiason, N. "Shell Bermuda arm seeks money from UK taxpayers", 30 July 2006.
<http://observer.guardian.co.uk/business/story/0,,1833084,00.html>

31. Consultation document, p.57, para 42.

32. Consultation document, p. 53-54, para 26: "There is no hard evidence that ECGD's foreign content policy alone determines whether or not UK exporters win business".

33. Consultation document, p.55, para 31: "... any change will affect a very small number of cases and is likely to be of marginal influence in the winning or losing of an export contract."

The 1991 Export and Investment Guarantees Act places a general duty on the ECGD to facilitate exports. The ECGD has consistently interpreted this duty as requiring that it treat all exporters, large and small, equally. **The five consultees would question whether the adoption of new procedures that clearly disadvantage some exporters over others (in the absence of a strong sustainable development rationale) is compatible with the ECGD's interpretation of its duty, particularly where the case for making such changes is acknowledged by ECGD to be weak.** This issue is not addressed in the Consultation document.

The five consultees recommend that:

- The ECGD should make public its views as to how a decision that it recognises may adversely affect smaller UK exporters whilst benefiting larger multinationals would be compatible with its duties under the 1991 Export and Investment Guarantees Act.

7. Quantifying impacts on revenue to UK Treasury

Given that ECGD's aim is "to benefit the UK economy", the analysis appears incomplete without any calculation of the potential lost revenues to the UK government as a result of increased foreign content. The growth of offshore registered applicants and foreign suppliers / subcontractors is not likely to be revenue neutral for the UK Exchequer.

- ECGD should publish an analysis of the expected lost revenues to the UK Exchequer following an increase in the limit

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