Business Innovation and Skills Committee
Inquiry into Government Assistance to Industry
Submission by The Corner House

INTRODUCTION

1. The Corner House is a not-for-profit research and advocacy group, focusing on human rights, environment and development.

2. Over the past eleven years, The Corner House has closely monitored the support given to UK industry by the UK Export Credits Guarantee Department.[1]

3. The Corner House welcomes the Committee's current inquiry into "Government Assistance to Industry" and is grateful for the opportunity to comment on the issues that the Committee has chosen to examine. This submission focuses on the role of the Export Credit Guarantee Department (ECGD) in promoting exports and the supply of credit to small- and medium-sized enterprises (SMEs).

4. The Corner House notes that:

    - Claims by ECGD that it operates at no cost to the taxpayer are questionable. Two directorates of the European Commission – DG Competition and DG Trade – are currently investigating allegations that ECGD is hiding losses and placing operating costs "off balance sheet" through the use of a Special Purpose Vehicle known as GEFCO. Were ECGD to be required to consolidate GEFCO's accounts with its own, it is likely that estimates of ECGD's "value for money" would be substantially reduced.

    - In sharp contrast to other EU-based export credit agencies, the ECGD has an extremely poor record of supporting small- and medium-sized exporters, backing just a handful of the 4.7 million plus SMEs registered in the UK. Instead, the bulk of support has gone to companies that are profitable enough and big enough to buy private political risk insurance and medium-term credit in the market.

- ECGD's recent decision to weaken its environmental, social, human rights and anti-corruption due diligence in order to assist exporters is short-sighted and damaging to the UK's future export prospects. It is also likely to result in adverse impacts on the ground. The ECGD's effective abandonment of its absolute ban on supporting projects involving child and forced labour is of particular concern.
- Consideration should be given to incorporating ECGD into a dedicated Green Investment Bank as part of a wider industrial strategy aimed at building a low-carbon economy in the UK.

ECGD'S COST TO THE TAXPAYER

5. The Export Credits Guarantee Department (ECGD) is the UK's export credit agency.[2] It derives its functions and powers from the Export and Investment Guarantees Act 1991.[3] Its primary function is to facilitate the export of goods and services by providing companies with guarantees, credits and insurance. In carrying out its functions, the ECGD uses a variety of financial instruments including different forms of credit and insurance.
6. The British Exporters Association argues that ECGD represents good value for money, stating:

   > "ECGD's ability to generate wealth for the UK is clear: each £1 of ECGD operating costs helps to generate £85 (2010) of orders for UK companies and all at no cost to the UK taxpayer. This figure compares well with the UK Trade & Investment ("UKTI") statistics whose export support generates £16 for every £1 of taxpayer's money spent."[4]

7. In fact, the claim that ECGD operates at no cost to the taxpayer is questionable. Two directorates of the European Commission – DG Competition[5] and DG Trade[6] – are currently investigating allegations that ECGD is hiding losses and placing its operating costs "off balance sheet"

through the use of a Special Purpose Vehicle known as GEFCO (Guaranteed Export Finance Corporation).[7]

8. The allegations arise from analysis by The Corner House and Campaign Against Arms Trade of ECGD's and GEFCO's accounts.[8] The analysis found that the UK Treasury had provided GEFCO, through ECGD, with some £3.7 billion in loans to purchase loans made under ECGD's Fixed Rate Export Financing (FREF) from ECGD. GEFCO then refinances the loans. FREF, which enables UK exporters to offer finance at a fixed interest rate to potential buyers of its goods and services, has made massive losses in the past.[9]

9. In The Corner House and CAAT's view, ECGD's use of GEFCO circumvents and subverts the UK's legally-binding obligations under the export subsidy provisions of the World Trade Organisation's Agreement on Subsidies and Countervailing Measures.

10. These obligations require ECGD to charge its corporate customers insurance premiums that are adequate to cover the Department's long-term operating costs and losses. The premiums must cover the costs of any refinancing of ECGD loans, whether undertaken directly by ECGD or by GEFCO with ECGD support.

11. The requirement's intention is undermined, however, if ECGD "hides" or effectively reduces its reported losses and operating costs. Because ECGD's and GEFCO's accounts are not consolidated, the operating costs of GEFCO's refinancing activities do not appear on ECGD's balance sheet, meaning that ECGD's accounts do not reflect its actual operating costs.

12. Moreover, the mechanism used to refinance GEFCO's loans may be obscuring the true extent of ECGD's losses. Any default on a refinanced loan is covered by yet another additional loan to GEFCO from ECGD; this is not accounted for separately by either GEFCO or ECGD but is simply lumped together in GEFCO's accounts with other borrowings received. As a result, it is difficult, if not impossible, to assess how much of the money given to ECGD by the Treasury for GEFCO is for refinancing ECGD's loans and how much for writing off bad debt. The full extent of ECGD's losses is thus hidden.

13. **Were ECGD to consolidate GEFCO's accounts with its own, it is likely**

that its "wealth generating" ratio would be substantially reduced.

14. **The Corner House believes that the extent of subsidy involved in ECGD's operations has been substantially underestimated and should be investigated. An informed view of the extent of ECGD's support for UK exporters and its effectiveness requires that such subsidies are transparent and not hidden through off balance sheet vehicles such as GEFCO.**

ECGD's FAILURE TO SUPPORT SMEs

15. The Corner House supports the use of taxpayer-supported funds to assist exporters, particularly at a time of economic recession. But it is firmly of the view that such support should not be provided to companies that are able to finance their insurance and export finance needs through the commercial market.

16. According to ECGD's accounts, the Department has issued some £31.6 billion worth of guarantees and insurance policies, including renewals, since 1999, covering some 1,756 contracts. ECGD has not disclosed details of all the companies that received this support – its latest accounts, for example, record 198 policies being issued, of which only 47 were made public. From the publicly disclosed information, however, it is clear that only a handful of the 4.7 million small- and medium-sized enterprises (SMEs) in Britain[10] received support. By contrast, SMEs account for some 68.7 per cent of applications for support from Germany's export credit agency, Hermes.[11]

17. In the UK, the majority of ECGD support has gone – and continues to go – to major multinationals, notably Airbus. In 2009-10, Airbus accounted for over 90 per cent of the value of business underwritten and 83 per cent of the policies issued.[12] Such near-monopoly support for Airbus came at a time when SMEs were in desperate need of ECGD-backed finance because of the credit crisis and when other European export credit agencies were taking measures to ensure such support, for example, by obtaining exemptions from the European Union's state aid rules by allowing support for exports within the European Union.

18. Whilst ECGD has recently tailored a new bond facility that would benefit Airbus and Rolls Royce,[13] it has yet to respond in any substantive way to calls by SMEs for special facilities that would meet their needs. Moreover, the sole substantive new measure taken by ECGD explicitly to support UK exporters during the credit crisis – its 2009 Letter of Credit Guarantee Scheme – has resulted in just one million Euros' worth of support[14] being approved in the ten months since the Scheme was introduced (which runs only to 31 March 2011).[15]

19. The Corner House agrees with the British Exporters' Association (BEXA)[16] (and Vince Cable, the Secretary of State for Business Innovation and Skills, prior to his entry into government[17]) that many of the large multinationals that currently dominate ECGD's portfolio are in a position buy private political risk insurance and medium-term credit in the market.

20. The Corner House supports BEXA's proposal that ECGD "move on from its concentration in servicing large business". In addition, it would propose that ECGD be required to disclose the difference in the premiums it charges on individual contracts against commercial rates available for the same contract.

WEAKENING DUE DILIGENCE PROCEDURES

21. The Corner House believes that, as a taxpayer-backed and subsidised institution, ECGD should condition its support for companies on their adhering to strict anti-corruption, environmental, social and human rights standards.

22. The Corner House is therefore extremely concerned by ECGD's decision in May 2010 to weaken its environmental and social due diligence procedures on the grounds that these procedures had placed UK exporters at an international competitive disadvantage. In future, ECGD will restrict its anti-corruption, social and environmental screening and assessment procedures only to those standards agreed internationally by the Export Credit Group of the Organisation for Economic Co-operation and Development (OECD).

23. As a result, ECGD will no longer assess the environmental and social impacts

of projects whose repayment term is under two years or in which the UK exporter's share of total project costs is less than SDR 10 million (equivalent to £10 million).

24. The new rules mean that ECGD's absolute ban on supporting child and forced labour is now ineffective, since a range of projects will no longer be assessed for the potential involvement of such practices. As a result, there is a high risk that ECGD will support child and forced labour. Moreover, applicants will no longer even be informed that ECGD has such a ban, rendering it hard, if not impossible, for ECGD to seek recourse in the event that child or forced labour is discovered after a project has been approved.

25. ECGD's claim that UK exporters would be at a disadvantage if it maintained its previous procedures, under which all projects (other than aerospace and defence contracts) were screened for environmental and social impacts regardless of value or repayment terms, is highly misleading. As the OECD's own figures reveal, the majority of ECGD's main competitor ECAs have stricter procedures than those of ECGD. The OECD records, for example, that 20 out of 31 member state ECAs conduct some form of review of projects with repayment terms less than two years[18] and that 15 ECAs screen projects regardless of value.[19] The OECD's assessment also reveals that the majority of member ECAs apply a range of standards that are additional to those required under agreed OECD rules.[20]

26. **The Corner House believes that the ECGD's current policy is short-sighted and damaging to the UK's future export prospects. Not only does it disadvantage those firms, including many SMEs, that have introduced procedures for ensuring compliance with international environmental, social and human rights standards, but, by permitting lower standards, it also will leave many companies ill-equipped to take advantage of the rapidly growing markets for "green" goods and services**.

27. In addition, poor due diligence can lead to companies breaking the law, with potentially adverse consequences for jobs. Three companies supported in the past decade by ECGD have recently been convicted in the UK: Mabey and Johnson and M. W. Kellogg for corruption offences; and BAE Systems for

false accounting. Such convictions have the potential to deny companies future contracts in the US and in the EU.

28. Despite such impacts, the ECGD's recently introduced Letter of Credit Guarantees Scheme was exempted from ECGD's standard anti-corruption procedures, in favour of "outsourced" due diligence by the participating banks. It is thus of grave concern that one Nigerian bank – Intercontinental Bank – named by ECGD as an "issuing bank"[21] in the Scheme[22] recently had to be bailed out by the Central Bank of Nigeria as a result of its allegedly corrupt practices.[23]

29. The Corner House believes that the ECGD's current policy of stripping back its due diligence in order to attract a wider exporter base is misplaced and recommends that ECGD should reinstate its previous screening and assessment procedures for all projects, regardless of value and repayment terms.

INCORPORATING ECGD INTO A GREEN INVESTMENT BANK

30. Despite a decade or more of government ministers directing ECGD to broaden its customer base and to support more SMEs, ECGD has failed to deliver.

31. The Corner House believes that consideration should be given to restructuring ECGD as part of a wider industrial strategy aimed at building a low-carbon economy in the UK. This would mean abandoning the ECGD's current business model of supporting all exporters regardless of their size or activity and focusing instead on support for exporters developing low-carbon technologies.

32. A recent report by Platform and the World Development Movement (WDM) warns that the UK's low carbon manufacturing sector is currently lagging far behind both its continental European counterparts and newly industrialising countries. According to the report, investment in this sector – including support for exporters – has the potential to generate some 50,000 jobs a year.[24]

33. Platform and WDM note that there is already wide political support for a Green Investment Bank to promote a low-carbon economy. The two groups recommend that the Royal Bank of Scotland (RBS), now owned by UK

taxpayers, should be transformed into such a bank, providing investment to create a sustainable economy.

34. Incorporating ECGD into a new Green Investment Bank would give the ECGD direct access to the exporters it needs to support if it is to deliver the Coalition Government's stated aim of transforming the Department into a champion "for British companies that develop and export innovative green technologies around the world, instead of supporting investment in dirty fossil-fuel energy production."[25]

35. Such direct, daily contact with green exporters would also provide a strong stimulus for ECGD to develop the sort of bespoke export finance packages, such as guarantees on bonds, that would assist UK green exporters in winning business abroad. Such guarantees should be conditional on the companies issuing them being under a legally-binding contract to have management systems in place that ensure adherence to international environmental, social anti-corruption and human rights standards in their operations at home and abroad.

The Corner House

24 September 2010

---

1 The Corner House has participated in nine field missions to assess the social and environmental impacts of several projects for which ECGD support has been sought. It has undertaken in-depth research into a number of ECGD-backed projects that have been tainted by allegations of bribery. *See*, for example:

—The Ilisu Dam, the World Commission on Dams and Export Credit Reform: *The Final Report of a Fact-Finding Mission to the Ilisu Dam Region*, October 2000 http://www.thecornerhouse.org.uk/resource/ilisu-dam-world-commission-dams-and-export-credit-reform.

—*Turning a Blind Eye: Corruption and the UK Export Credits Guarantee Department*, June 2003 http://www.thecornerhouse.org.uk/resource/turning-blind-eye.

2 Export credit agencies (ECAs) are public, quasi-public or private agencies that provide loans, guarantees, credits and insurance to private corporations from their home country to assist them doing business overseas. Such support is particularly requested for projects in the developing world because of the perceived financial and political risks involved in such projects. The support requested would be more expensive if obtained through the private sector. Where the ECA is public or quasi-public, the loans are backed by the agency's national government.

3 Under the Export and Investment Guarantees Act 1991, ECGD, acting on behalf of the Secretary of State for Business, Enterprise and Regulatory Reform, is required to " facilitat[e], directly or indirectly" the supply of British exports.

4 British Exporters Association, "Export Credit Agencies: Export support available to British exporters, ECGD benchmarking", July 2010, http://www.bexa.co.uk/docs/Final%20-%202010-07-26%20bexa%20research%20-%20eca%20benchmarking%20report%20(final)1.pdf

5 DG Competition, "CP 80/2010: Complaint against the UK export credit scheme", Letter to The Corner House and Campaign Against Arms Trade, 12 July 2010, http://www.thecornerhouse.org.uk/sites/thecornerhouse.org.uk/files/8152-545%20CP80-10%20UK.pdf.

6 DG Trade, Letter to Campaign Against Arms Trade, 29 July 2010, http://www.thecornerhouse.org.uk/sites/thecornerhouse.org.uk/files/Complaint%20CHAP%282010%2902320.pdf.

7 "Complaint to EU concerning alleged unlawful state aid to UK's export credit agency: Refinancing through GEFCO raises questions about ECGD's financial losses", 23 March 2010 and subsequent, http://www.thecornerhouse.org.uk/resource/complaint-eu-concerning-alleged-unlawful-state-aid-uks-export-credit-agency.

8 The Corner House and Campaign Against Arms Trade, "Complaint to EC concerning alleged unlawful state aid to UK's export credit agency", 22 March 2010, http://www.thecornerhouse.org.uk/sites/thecornerhouse.org.uk/files/Complaint%20FormFINAL.pdf.

9 The Treasury describes the losses under FREF as "massive" and estimated in 2004 that the scheme had cost the taxpayer more than £15 billion since 1972.

See:

"The Future of ECGD", Treasury briefing for Non-Governmental Organisation, 2004 (copy available on request).

10 British Exporters Association, "Export Credit Agencies: Export support available to British exporters, ECGD benchmarking", July 2010, http://www.bexa.co.uk/docs/Final%20-%202010-07-26%20bexa%20research%20-%20eca%20benchmarking%20report%20(final)1.pdf.

11 British Exporters Association, "Export Credit Agencies: Export support available to British exporters, ECGD benchmarking", July 2010, http://www.bexa.co.uk/docs/Final%20-%202010-07-26%20bexa%20research%20-%20eca%20benchmarking%20report%20(final)1.pdf.

12 ECGD, *Annual Review and Resource Accounts 2009-10*, p.8, http://www.ecgd.gov.uk/assets/bispartners/ecgd/files/publications/ann-reps/ecgd-annual-review-and-resource-accounts-2009-10.pdf.

13 "Deal Analysis: AerCap's ECA bond", *Airfinance Journal*, 8 September 2010, http://www.airfinancejournal.com/Article.aspx?ArticleID=2663612.

14 ECGD, "ECGD helps Spooner Industries deliver Euro 5 million order", 20 August 2010, http://www.ecgd.gov.uk/news-and-events/news/ecgd-helps-spooner-industries-5mil-euro-order.

15 ECGD, "New Letter of Credit Guarantee Scheme to provide short-term export finance", 20 October 2009, http://www.ecgd.gov.uk/news-and-events/news/new-let-cred-short-term.

16 The British Exporters' Association states:

> “the commercial reality is that a large company which already pays substantial annual premium for a well-spread portfolio of risk and is able to take a high level of risk share can generally secure cover on insurable risk, even for the more economically challenging contract structures, credit risks, horizons or destination customers and/or countries”

See:

British Exporters Association, “Export Credit Agencies: Export support available to British exporters, ECGD benchmarking”, July 2010, p.7, http://www.bexa.co.uk/docs/Final%20-%202010-07-26%20bexa%20research%20-%20eca%20benchmarking%20report%20(final)1.pdf

17 In February 2004, the Rt Hon Vince Cable MP stated:

> “When my former colleagues in the oil industry and others approach the Minister for help, why cannot they be told that it is possible to buy private political risk insurance and medium-term credit in the market? Why does the taxpayer have to underwrite it?”

See:

Hansard, 26 Feb 2004: Column 407, http://www.publications.parliament.uk/pa/cm200304/cmhansrd/vo040226/debtext/40226-04.htm.

18 OECD Working Party on Export Credits and Credit Guarantees, “Export Credits and the Environment: 2009 Review of Members’ Responses to the Survey on the environment and officially supported export credits”, 29 April 2010, http://www.olis.oecd.org/olis/2009doc.nsf/LinkTo/NT000098F2/$FILE/JT03282654.PDF

Para 88 of the OECD report, which was based on a survey conducted prior to ECGD stripping back its procedures, states:

> “Short-term business is reviewed for potential environmental impacts on a case-by-case basis: nine Members/ECAs, *i.e.* Austria, Canada, Denmark, Finland, France, Hungary Eximbank and MEHIB, New Zealand and Sweden.
>
> “Short-term business subject to separate environmental review procedure: three Members/ECAs, *i.e.* Germany, Mexico and Switzerland (if the value is over CHF 10 million).”
>
> “Short-term business is treated in the same way as other business under the 2007 Recommendation: eight Members/ECAs, *i.e.* Australia, Belgium, Japan JBIC, Luxembourg, Netherlands, Norway, Slovak Republic and United Kingdom.”

19 OECD Working Party on Export Credits and Credit Guarantees, “Export Credits and the Environment: 2009 Review of Members’ Responses to the Survey on the environment and officially supported export credits”, 29 April 2010, http://www.olis.oecd.org/olis/2009doc.nsf/LinkTo/NT000098F2/$FILE/JT03282654.PDF

Paragraph 21 of the OECD Report shows that 15 ECAs (out of 31 from 30 countries) classify all projects regardless of value, 15 impose a SDR 10 million limit and one sets a SDR 20 million limit .

20 OECD Working Party on Export Credits and Credit Guarantees, “Export Credits and the Environment: 2009 Review of Members’ Responses to the Survey on the environment and officially supported export credits”, 29 April 2010, http://www.olis.oecd.org/olis/2009doc.nsf/LinkTo/NT000098F2/$FILE/JT03282654.PDF

Para 38 of the OECD assessment records, for example, that:

> "20 ECAs use such international standards on a case-by-case basis when such standards "are more stringent than or not addressed by World Bank Group standards."
>
> "18 ECAs gave examples of using European Community standards, but also, for example, those of the World Health Organisation".

Para 42 states:

> "Eleven Members/ECAs reported that they might apply additional standards for issues not adequately addressed by the primary standards, such as unique effluent or discharge (Canada), animal production (Denmark), social issues (Korea Eximbank) and emissions (Sweden)."

Para 43 states:

> "Twenty Members/ECAs reported that they may use other internationally recognised sector specific or issue specific standards where such standards are not addressed by the World Bank, such as,
>
> - Exporting country standards for air quality (Germany) and animal production (Denmark)
> - International Atomic Energy Agency (IAEA) standards for nuclear projects (Canada,
> - Italy and United States)
> - International Commission on Large Dams (ICOLD) (Hungary Eximbank and MEHIB)
> - International Cyanide Management Code (Canada)
> - IUCN Red list for endangered species (Italy and Japan NEXI)
> - MARPOL Convention (Canada and Japan NEXI)
> - Montreal Protocol (Spain)
> - Multilateral Investment Guarantee Agency standards for investment insurance
> - (Hungary MEHIB)
> - World Commission on Dams and International Hydropower Association (Austria,
> - France, Germany, Spain and Sweden)
> - World Health Organisation for water quality (Canada)".
>
> "Three Members/ECAs, *i.e.* Belgium, Netherlands and Turkey, reported that they may use other internationally recognised sector specific or issue specific standards on a case-by-case basis."

21 The issuing bank issues a Letter of Credit, which is a long-established instrument in trade finance. When a UK company sells goods overseas, it will typically make it a condition of the contracts it draws up and signs with the buyer that the buyer arranges for its own bank to give an irrevocable undertaking – which takes the form of a "letter of credit" – to pay for the goods exported once documentary evidence is produced that the goods have been shipped from the exporter. This is known as an "unconfirmed" letter of credit. Where the UK exporter fears that the overseas bank may default on this undertaking, the exporter arranges (upon payment of a fee) for a UK bank to "confirm" the letter of credit. In this instance, the exporter is paid by the UK bank on production of the shipping documents – and it is then the responsibility of the UK bank to obtain repayment from the overseas bank.

22 ECGD, "Letter of Credit Guarantee Scheme: List of Issuing Banks", http://webarchive.nationalarchives.gov.uk/tna/+/http://www.ecgd.gov.uk/ecgd_issuing_banks_pdf-2.pdf/.

23 The Governor of the Central Bank of Nigeria, Lamido Sanusi, ascribed the collapse of Intercontinental Bank to "poor corporate governance practices, lax credit administration processes and the absence or non-adherence to the bank's credit risk management practices."

The CDC Group, a company wholly owned by the UK's Department for International Development, notes that the Nigerian banking collapse was provoked in large part by "favourable loans being offered to associates of many of the banks' executives". CDC Group was itself invested in Intercontinental.

See:

Address by the Governor of the Central Bank of Nigeria, Mallam Sanusi Lamido Sanusi, on Developments in the Banking System in Nigeria on 14 August 2009,
http://www.imoisilis.com/2009/08/full-text-of-cbn-governors-speech-on.html

CDC Group Plc, *Development Review 2009*, p.48, 2010,
http://www.cdcgroup.com/uploads/development_review_2009.pdf.

Connor, W., "Nigeria plans $2.6 billion bank bailout, ousts top executives", *Wall Street Journal*, 15 August 2009
http://online.wsj.com/article/SB125029804018633595.html

Central Bank of Nigeria Advertorial, 18 August 2009,
http://www.cenbank.org/Out/publications/pressRelease/GOV/2009/ADVERTORIAL2.pdf

24 Leaton, J., and Reed, H., *A Bank for the Future: Maximising public investment in a low-carbon economy*, Platform and World Development Movement, 2010, p.12,
http://www.wdm.org.uk/clean-banks/bank-future-maximising-public-investment-low-carbon-economy.

25 Cabinet Office, *The Coalition: Our Programme for Government*, 2010,
http://www.cabinetoffice.gov.uk/media/409088/pfg_coalition.pdf.