The finance of medium and long-term export and shipbuilding credits

In November 1971 a Working Party composed of representatives of the relevant government departments, the London and Scottish clearing banks and the Bank of England was set up to review the existing special scheme for the finance of medium and long-term credit for exports and shipbuilding. Under these arrangements the banks undertook to make finance available at a fixed rate of interest agreed with the authorities and were able in certain circumstances to refinance part of it with the Issue Department of the Bank of England. The banks provided finance for exports against the security of guarantees from the Export Credits Guarantee Department, and for domestic shipbuilding against guarantees given by the Department of Trade and Industry under the Shipbuilding Industry Acts 1967 and 1971.

These arrangements were substantially revised and consolidated in 1969.[1] But despite some further modifications, the scheme proved increasingly unsatisfactory in some respects. The fixed rate, which had remained unchanged at $5\frac{1}{2}\%$ for a number of years up to 1970, had provided the banks with a relatively low return during a period of high interest rates; and during this period the banks had become increasingly concerned at the rising volume of future financing to which they were committed as well as the extent to which they were exposed to substantial fluctuations in market rates. In recent years, too, as the amount of refinance undertaken and in prospect for the Issue Department of the Bank of England increased, it began to appear that the growing proportion of its portfolio held in this form could lead to an impairment of the Department's market management functions.

It was against this background that the Working Party considered ways in which this business might be undertaken in the future. Based on its recommendations, agreement was reached between the London and Scottish clearing banks and the authorities on new arrangements which were announced in the House of Commons by the Minister for Trade on 15th March and came into effect the following day.

Under the new scheme the banks continue to provide all the credit to their customers in the first instance, thus maintaining the relationship with them; and, as before, their lending is backed by guarantees from the Export Credits Guarantee Department and the Department of Trade and Industry. The banks will also continue to finance a substantial part of the outstanding credit themselves but the limit on the extent of their commitment has been set at 18% of their current account deposits instead of 10% of gross deposits as formerly. Current account deposits are defined, for this purpose, as currency and sterling balances held on current account at U.K. offices, transferable or withdrawable on demand without interest penalty, after adjustment for items in transit. In calculating this percentage the total of current accounts, as with gross deposits under the 1969

[1] Earlier refinancing schemes relating to export credits were described in the March and June 1961 and March 1965 issues of the *Bulletin*, and the fixed rate shipbuilding credits scheme and refinancing facility was described in the June 1967 *Bulletin*. The banks' original arrangements for fixed rate lending for exports were described in the March 1962 *Bulletin*. For the 1969 arrangements see the issues of the *Bulletin* for September and December 1969.

scheme, is taken as the average outstanding over the preceding twelve months. The new limit of 18% of current accounts was broadly equivalent to 10% of gross deposits at the time the new scheme was introduced, and was accepted as a more suitable measure for the clearing banks' commitment to finance fixed rate paper in the changed environment following the introduction of the new system of credit control. Eligible paper held by any bank in excess of this figure is refinanced with the authorities.

All new refinance for exports is being provided by the E.C.G.D. under Section 2 of the Export Guarantee Act 1968, as amended in 1970. For shipbuilding credit it is intended that the D.T.I. should provide all new refinance when it has the necessary powers to do so. In the meantime any additional refinance required for shipbuilding will continue to be provided by the Issue Department. It will also maintain its existing refinance for both exports and ships for the time being, but the intention is that this should be phased out gradually over the next few years.

A major change under the new arrangements is that the return to the banks on that part of their lending which they continue to finance themselves will no longer necessarily be the same as the fixed rate or rates paid by the borrower. It will instead vary broadly in line with market rates, being recalculated each month in accordance with an agreed formula. This formula is the average of the Treasury bill yield and the clearing banks' syndicated lending rate for nationalised industries, plus a margin of 1¼% to allow in particular for the fact that the banks are tying up their funds for a period of years in unmarketable assets. The fixed rates to be paid by the exporter or shipowner are now determined by the Government alone and, as before, will be reviewed from time to time in the light of comparable rates abroad and general economic considerations. Any difference between the agreed rate of return to the banks each month and the fixed rates at which the advances have been made, which may be in favour of the banks or the Government, is settled through an adjustment in the interest payable by the banks on the amounts refinanced.

The present arrangements have been constructed for the London and Scottish clearing banks and apply only to them. There is no reason, however, why other banks should not undertake this type of lending, and consideration is being given to the terms on which they might participate in a similar scheme.

The fixed rate of interest for exports (other than exports of ships) was reduced on 16th March from 6½% to 6% and applies to all contracts signed on and after that date. The rate had previously been increased from 5½% to 7% on 1st October 1970 and then reduced from 7% to 6½% in November 1971. The fixed rate for shipbuilding credit (including exports of ships) is being maintained at 7% (it was raised from 5½% on 1st October 1970) in order to comply with the O.E.C.D. Understanding on Export Credits for Ships. The rate of return to the banks under the agreed formula when the new scheme began was just below 6%.

Under Part I of the 1969 arrangements, the Bank had provided certain emergency refinance facilities. These were available to the London and Scottish clearing banks and to other banks incorporated in the United Kingdom or the Commonwealth which were substantially British-owned and controlled and which traditionally provided export or shipbuilding credit to their customers. The banks concerned were able to treat amounts eligible for refinance under these arrangements as liquid assets for balance-sheet purposes. Since the introduction of the new credit control arrangements in September 1971, however, the liquid assets ratio formerly observed by the clearing banks has lost its significance, and all fixed rate export and shipbuilding credits are to be treated as advances for balance-sheet purposes. It is recognised, however, that circumstances could still arise in which some emergency refinance arrangements might be required by banks undertaking this type of lending. The Bank have therefore agreed to make facilities available on the lines of the former Part I arrangements under which a bank could in appropriate circumstances receive help in an emergency situation – for example, to meet a sudden and unexpected withdrawal of deposits. The amount of refinance to be made available under this facility would be decided by the Bank, after discussions with the bank concerned, in the light of the particular circumstances at the time.

The new scheme will be reviewed after three years or earlier at the request of either the banks or the authorities. It is hoped, however, that it will provide a continuing means of financing medium and long-term export and shipbuilding credit. The banks will receive a rate of return more closely related to the yield on alternative forms of employment for their resources. At the same time the Government will be able to fix rates to the borrower taking into account broad considerations relating to the best use of national resources while avoiding undue fluctuations in rates for this type of lending.