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

Towards the end of last year it was announced that the scheme for financing medium and long-term export and shipbuilding credits was to be slightly amended, and that arrears of interest which had become due to the clearing banks were to be paid off. This note records and explains these developments.

Briefly, under the scheme as revised in March 1972,[1] the London and Scottish clearing banks continued to provide initially all the necessary credit to their customers, against guarantees from the Export Credits Guarantee Department or, for home shipbuilding credits, from the Department of Trade and Industry (now the Department of Industry); but any lending beyond 18% of their current account balances was refinanced with the ECGD or the DTI as appropriate. The return to the banks on that part of their lending which they continued to finance themselves was no longer necessarily to be determined by the 'fixed rate' charged to the borrower, but an 'agreed rate' of return was introduced which was related to an 'observed rate' made up of the average of the Treasury bill yield and the clearing banks' lending rate for nationalised industries; to this observed rate, which was to be recalculated each month, was added a margin of 1¼% to allow for the banks' costs in operating the scheme and developing new export business, and reflecting the tying up of their funds for a period of years in unmarketable assets.

The fixed rate to the borrower was to be determined in future solely by the Government in the light of competitive rates abroad and general economic considerations, together with any international obligations to which the United Kingdom was, or might become, a party.[2] Any difference between the agreed rate of return to the banks and the fixed rate, which could in principle be in favour either of the banks or of the Government, was to be settled through an adjustment in the interest payable by the banks on the refinancing loans, there being no statutory authority to enable the departments concerned to make direct payments to the banks for this purpose.

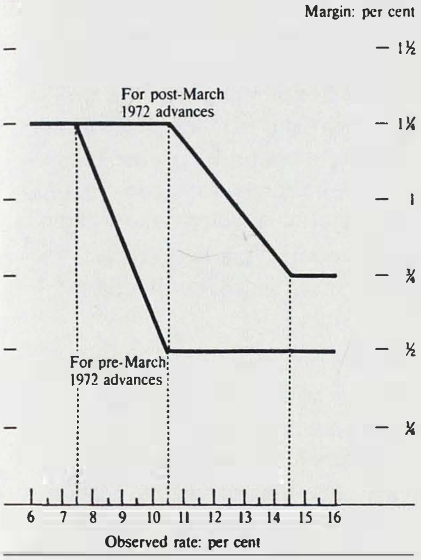
The agreement between the banks and the authorities provided for a review of the arrangements after three years, or earlier at the request of either side, but it was nevertheless hoped that they would provide a continuing and effective means of making available the necessary finance. However, two developments prevented their working as smoothly as had been hoped. First, there was a large increase in market interest rates, which opened a substantial gap between the agreed rate and the fixed rate; and secondly, the total of fixed-rate credit eligible for refinance grew more slowly than had been expected. Consequently, sums due to the banks under the agreed-rate formula were greater than the sums due to the Government as interest on the refinancing loans, and the net amount due to the banks continued to increase month by month without any effective means of paying it off.

Meetings to discuss the problem began early in 1974 between the government departments concerned, the London and Scottish clearing banks, and the Bank of England. At the same time, the opportunity was taken for a general review of the scheme in accordance with the terms of the 1972 agreement. Discussions continued for most of the year, and agreement was eventually reached in November on a revision of the scheme which leaves its basic principles intact, but which in certain circumstances reduces the rate of return to the banks. Under the revised

[1] For further details of these arrangements, and references to earlier articles covering the history of the various refinancing schemes, see the article in the June 1972 *Bulletin*, page 205.

[2] For subsequent changes to the fixed rate see the March 1974 *Bulletin*, page 21, and the September 1974 *Bulletin*, page 269. Also, on 4th December 1974, the Government announced that international agreement had been secured on a minimum rate of 7½% for export credit of over five years.

Margin of agreed rate over observed rate



arrangements, the refinancing threshold of 18% of current account balances remains, but the agreed rate of return to the banks on unrefinanced lending is tapered, so that the amount of the margin over the observed rate falls as the observed rate itself increases. The formula in respect of advances made by the banks before the March 1972 agreement differs from that in respect of advances made subsequently: the chart illustrates the position. The new arrangements are deemed to have come into effect on 17th October 1974, and, as before, are to run for three years, subject to earlier review at the request of either side.

In return for the banks entering into the new and extended arrangements, the Government undertook to seek authority from Parliament to pay the arrears of interest due, and to seek powers to enable direct interest grants to be made to the banks if that should be required in future. Accordingly, on 21st November the Government announced that the winter Supplementary Estimates would provide for the payment of the arrears and that legislation to cover future payments would be introduced as soon as possible. To this end, the Export Guarantees Amendment Bill was introduced in December and payments in respect of home shipbuilding were covered in the Industry Bill introduced in January. The arrears, which then amounted to £111·4 million, were paid on 15th January.

It remains the intention that banks other than the clearing banks should be enabled to undertake the type of business covered by the arrangements, although their inclusion has hitherto been inhibited by the difficulties arising in the clearing banks' scheme. Fresh consideration is now being given to the terms on which other banks might participate in a similar scheme.