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British Economic Colonialism: the use of export credits to support UK arms exports

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Summary

This article estimates the subsidy provided by the ECGD to UK arms exports. We derive a risk adjusted market required return on ECGD sovereign loan guarantees from the international bond markets. We consider this provides a more reliable estimate of economic cost than the value at risk model used by ECGD. We estimate the ECGD subsidy to arms exports is well above £200m per annum. This subsidy would appear to primarily benefit UK banks and large established firms. We propose that the government provides such subsidies for a variety of reasons which we group together under the term 'economic colonialism'.

Economic Colonialism

We define '*economic colonialism*' as UK Government action that distorts the market for UK and developing nation resources so as to benefit UK and developing nation elites and to the detriment of the broader populations of either or both countries. Defined in this way, Economic colonialism is the international dimension of mercantilism, which has in turn been defined as the use of Government action to restrict or otherwise modify markets for the benefit of certain players in that market.²

Economic Colonialism involves the use of government departments to support particular companies or industries (notably through the ministries such as the Department for Trade and Industry and Ministry of Defence) using explicit subsidies, tax-breaks, favourable regulation, advice, contacts and other mechanisms. This is more than a simple question of bribery, political donations or revolving doors, though of course these have to varying degrees, played a role. These interventions are particularly prevalent in the promotion of exports, where governments have stronger motivations to intervene because of the impacts on relations with other governments and elites.

The Export Credit Guarantees Department (ECGD) presents a particularly instructive example of Economic Colonialism. The department has become a useful tool for governments to subsidise the exports of a relatively small number of well-connected companies. While its mission statement mentions the wider UK economy, it is clear from repeated communications with ECGD officials that it interprets its mission as simply to promote UK exports.³ The institution is mercantilism personified.

¹ This article does not pretend to be an academic research paper, but rather reports on work in progress that has involved extensive discussions with government economists and corporate treasurers. There are undoubtedly areas in this work that need to be further developed, and the authors would appeal to any researchers in the area to develop this work, because it has significant implications for future government policy over export credit insurance. Paul Ingram (mail@paulingram.org.uk) and Mark Ingram (fme@freeuk.com)

² Phelps, E.S., *Political Economy* (1985, Norton, New York). p. 24.

³ "To benefit the UK economy by helping exporters of UK goods and services win business and UK firms to invest overseas, by providing guarantees, insurance and reinsurance against loss, taking into account the Government's international policies." ECGD Annual Report 2001-2, p. 4

Governments of every shade have intervened in the market. Whilst ostensibly for economic reasons in the general interest, it is our contention that the net effect has been to consolidate the political and economic position of an elite.

Trade

Despite the academic disrepute earned by mercantilism, ever since Adam Smith set out to tear down the widespread assumption that exports could be used by a state to amass wealth from other countries, governments have continued to champion exporters on the grounds that this automatically benefits our economy. Trade, rather than diplomacy, is increasingly used by the Foreign Office to justify its operations in embassies around the world, but has always played a strong part in the priorities of our Ambassadors, particularly in promoting military equipment⁴.

Economists have long recognised that the market pricing mechanism should capture all the direct *economic* benefit from exports. Individual participants within a market can attempt to change the distribution of any economic gains from trade through the exploitation of some distinguishing feature or by distorting the market itself.⁵ In addition there may be costs or benefits not accounted for by the market which are, by definition, externalities.

Assuming that Government intervention is economically rational,⁶ it must therefore occur in the context of either an attempt to distort the market in favour one party at the expense of another, or to ameliorate some market externality.⁷

Trade externalities can be either positive or negative. Positive externalities include the transfer of benign technology, international communication, and conflict resolution (though the debate may still be out on this). Negative externalities include the environmental impact of transportation, the proliferation of dangerous technologies, the social cost of trade in damaging products such as drugs and child pornography, increased economic volatility from specialisation, and lack of local control over production and consumption patterns.

In general the consequences of a locally based trade are readily apparent to all participants. Conversely world trade requires participants to be appraised of transaction consequences via an efficient communications process – or to trade in the absence of a full understanding of the context of that trade.

There is little quantified evidence concerning such externalities. It is therefore unclear whether facilitating trade beyond that which would exist in an efficient market context is beneficial or detrimental. However, what is clear is that individual government departments may have their own specific agendas when intervening to support particular favoured companies or sectors, and have little knowledge or interest in the negative externalities that result.

Export promotion and trade justice: a particular externality

Aid agencies and others have been highlighting the 'unfair' trade rules that govern much international business for many years. In what Joseph Stiglitz, Nobel laureate and former chief economist and senior vice-president of the World Bank, has described as 'new colonialism', third world countries have economic policies dictated to them by international financial organisations run largely by the G7 and the United States in particular.⁸

Recently aid agencies have focused on the practice of 'dumping' particular products such as agricultural surpluses on developing countries, depressing local markets and destroying production

⁴ The former British Ambassador to Iran in the 1970s, for example, has said that the vast majority of his time was taken up selling British arms to the Shah.

⁵ For example, information asymmetries, monopoly power and branded goods.

⁶ There might be some legitimate debate on this point. Political action need not be economically rational in order to be politically rational. However, it is our view that in the longer term economic rationality and political rationality usually coincide, and that therefore this premise is true *in the longer term*.

⁷ Such favouritism need not be in the interests of an elite. Government intervention in markets need not therefore be interpreted as negative if the intervention corrects an *injustice*. The concept of a just intervention is beyond this paper. We would, however, assume that such an intervention would be accompanied by extensive publicity if it were in the interests of a group that would otherwise be unaware of such benefits.

⁸ Nayar, D. (ed), *Governing Globalisation – Issues and Institutions* (2002, World Institute for Development Economics, United Nations University, New York).

and livelihoods in recipient countries. Export subsidies, while lowering the cost of products to recipient countries, can have long-term negative impacts, deepening dependencies.

Arms exports

The Ministry of Defence has particularly close connections with a small number of prime contractors who benefit from favourable business relationships that extend beyond the award of MoD procurement contracts to the subsidised promotion of arms exports.⁹ Arms exports enable the buyer to use or threaten the use of force. This is the ultimate mechanism by which many elites govern. They are therefore of particular interest when forming or maintaining political relationships between Governments. They are also usually secret, shielded from many commercial disciplines and are often very large and cover extended periods of supply and use.

Arms sales create a critical and fundamental political dependency for the recipient state on the supplier. Not only might these arms be essential for the survival of the political elite of the client state, but also they will continue to be dependent as long as they need the spare parts, service expertise and training skills of the supplier state. Arms sales frequently follow political allegiances.

Arms export control policy has been catapulted into the political spotlight by the Scott Inquiry, talk of an ethical foreign policy, and most recently with the Export Control Bill. A common public assumption in this debate has been that an ethical foreign policy and the control of the proliferation of weapons technology to countries of concern has to compete with the benefit arms exports bring to defence procurement, jobs and our economy. This perceived benefit has been a useful context for successive governments when subsidizing UK arms exports.

This perceived domestic economic benefit came under scrutiny in *The Subsidy Trap*, a report published in July 2001 by Oxford Research Group and Saferworld. It estimated annual government subsidies to arms exports to be of the order of around £420m, or £4,600 for every job in arms exporting.¹⁰ A large slice of this subsidy (£227m net) came from our estimates of ECGD support for UK arms exporters. This subsidy was measured by estimating a risk adjusted market required return on ECGD sovereign loan guarantees from the international bond markets.

In December 2001, MoD economists and independent academics (Malcolm Chalmers, Neil Davies, Keith Hartley and Chris Wilkinson) teamed up to publish a report (the 'York Report') on the economic impact of a halving of defence exports.¹¹ This report concluded that "the economic costs of reducing defence exports are relatively small and largely one-off". It went on to suggest that the level of employment is likely to benefit as a result of investments being transferred to more labour-intensive (but lower wage) economic activities. This paper is a positive, welcome contribution to this important area, adding considerable value to the discussion on export subsidies and signalling a willingness in certain parts of MoD to take the broader economic arguments seriously and to engage in a discussion with respected independent academics.

However, we believe this report once again significantly underestimated the full annual subsidy to UK arms exports provided by the ECGD. The report relied on estimates of subsidy using volatility data provided to them by the ECGD and accepted the approach used by the ECGD in their move to a Trading Fund status. Why they chose to accept the ECGD methodology we are unable to explain; the authors were aware of our alternative approach but chose not to discuss it. Soon after publication of *The Subsidy Trap*, ECGD support to the defence sector significantly increased.¹²

We engaged the Department in a debate on the relative methods, for external reporting and subsidy measurement purposes, of using the bond market as a source of risk adjusted returns. Whilst privately acknowledging the strength of our approach, we suspect that the VAR approach is too convenient to be abandoned, with or without the significant and unavoidable estimation errors implicit within it.

⁹ Ingram, P. and Davis, I., *The Subsidy Trap: British Government Financial Support for Arms Exports and the Defence Industry*, (2001, Oxford Research Group/Saferworld, Oxford)., also forthcoming update.

¹⁰ *ibid*

¹¹ Chalmers, M., Davies, N., Hartley, K. and Wilkinson, C., *The Economic Costs and Benefits of UK Defence Exports* (2001, Centre for Defence Economics, University of York, York). The report is available in full at http://www.york.ac.uk/depts/econ/rc/defence_exports_nov01.pdf

¹² In 00/01 the proportion of ECGD guarantees given that were for the defence sector shot up from 29% to 48% (largely accounted for by the deal with South Africa). ECGD Review of the Year and Annual Report 2001/2.

Valuing the subsidy for ECGD

Malcolm Chalmers *et al* use a value at risk model to estimate the government subsidy to the UK arms exports to be between £16m and £96m a year.

We have no *conceptual* difficulty with the 'return on capital requirement' methodology used by the authors. However, this approach suffers from considerable uncertainties which we believe render the end result highly unreliable. These uncertainties relate to the amount of required capital and the required return thereon. We discuss each in turn below.

First, the value at risk (VAR) methodology used to calculate the capital requirement is predicated on an estimate of future volatility. This in turn is based upon prior historic volatility. ECGD is essentially exposed to sovereign, currency and interest rate risks over long contractual periods. We have considerable doubt as to whether historic volatility can be used to infer very much about future volatility in the sovereign risk market, even at the level of a portfolio of such exposures. Any such estimates are subject to such considerable uncertainty as to render them almost useless.¹³

Second, the return on this required capital is estimated by ECGD and the authors of the York Report at around 5%. This figure, whilst supplied by the ECGD, is not justified. In the case of defence-related business it also appears to contradict the Government's own evidence given to parliament in 2000, which implies an average annual historical loss on such contracts of £52 m over the ten years from 1991 to 2000.¹⁴ In any case, Chalmers *et al* compare this 5% ECGD return to the return required more generally on Government trading funds of 6%, to estimate an implicit 1% subsidy. Crucially, it is our contention that the rate of return should be risk adjusted. We would contend that equivalent risk adjusted returns on equivalent business written in the private sector banking markets would be substantially higher than 6% real.

The 2000 NERA Report commissioned by ECGD concluded that the ECGD's ability to offer competitive premium rates could be an indication of subsidy, suggesting that there needed to be a study to identify the costs to the Government of using its balance sheet to support ECGD activities.¹⁵ The report strongly suggests there was a subsidy (see appendix). In response, the Treasury and ECGD commissioned NERA to report further on such a subsidy to ECGD. This latest NERA report uses the VAR model to estimate the subsidy to ECGD and was published in early 2003.¹⁶ It did not justify VAR as against alternative approaches, and came up with a series of results for the subsidy based upon differing scenarios. None involved a significant annual subsidy of more than £50m. It relies heavily upon notional 'K-values', the ratio of unexpected to expected losses on deals, to cope with risk. It accepts the weakness of the approach:

"the robustness of the k-values is subject to a significant degree of uncertainty, which partly reflects the difficulties of estimating k-values at high confidence interval levels for "lumpy" exposures." (page 27)

The report attempts to overcome the uncertainties of estimating K-values by claiming that such uncertainties would suggest higher values within their confidence parameters (between -100% and +100%). But they have failed to justify the confidence parameters, and indeed there is no reason to suggest that K-values could not exceed 100% (ie. unexpected losses could be significantly greater than expected losses).

None of the reports above reconcile their conclusions to market risk premia charged in the international bond markets. If the UK Government is so good at managing sovereign risk then perhaps it should consider speculation in the international bond markets: on the basis of the NERA report they would make a killing! We extend this argument below.

¹³ Of course estimates of volatility might be estimated from the international bond markets. However, to do so would simply be to use our method indirectly. Since Chalmers *et al* consider that benchmarking against such markets is of itself wrong, it would be inconsistent for them to then derive their volatility estimates from such markets.

¹⁴ *The Subsidy Trap*, p. 21.

¹⁵ Estrin, S., Powell, S., Bagci, P., Thornton, S., Goate, P., *The Economic Rationale for the Public Provision of Export Credit Insurance by ECGD*, (2000, National Economic Research Associates, London) Cmd Paper 4791; available on the ECGD website at: <http://www.ecgd.gov.uk/nera.pdf>

¹⁶ Bagci, P., Powell, S., Grayburn, J., Kvekvetsia, V., and Venebles, A., *Estimating the economic costs and benefits of ECGD; a Report for the Export Credit Guarantees Department*, (2003, NERA, London); available on the ECGD website at: <http://www.ecgd.gov.uk/neraiifinalreportjan2003.pdf>

Our alternative approach

It is puzzling to us is that Chalmers *et al* and NERA have chosen to use VaR at the organisational level to estimate the ECGD economic subsidy when they were aware of a much simpler and reliable alternative, outlined in our report released earlier in 2001. Reference to our paper is made in the full study, and is dismissed as relying on 'inferences from very different market activities'. We should like to explore this challenge below.

The ECGD provides finance facilities, credit insurance and overseas investment insurance to UK based companies. The bulk of these services entail providing guarantees to banks and/or corporates against non-payment by an overseas buyer (usually a foreign government) on long-term loans extended to that buyer so as to facilitate British exports. Whilst the detail of this relationship varies, the ultimate risks being insured relate to interest rates, foreign exchange rates and sovereign default.

Other risks, such as contract risk (i.e. the possibility of a dispute over the quality of goods) are also covered (under the EXIP scheme), and increase the exposure of the ECGD. We have no satisfactory method to quantify the value of these contract risks, and therefore valued them via an arbitrary 1% additional required return, or £41m per annum.

The value of the sovereign guarantees to the supplier or commercial lender may be readily ascertained from the international debt markets. Foreign governments borrowing dollars, for instance, pay a risk premium over the equivalent American Government bond rate. This reflects the fee levied by a commercial lender for taking on the risk of lending to that foreign government. The value of ECGD guarantees is therefore the difference between what the commercial lender would charge the foreign government had the loan not been guaranteed, and the equivalent rate were the loan to be made to the British Government (i.e. substantially free of foreign sovereign risk). We used the American Government bond rate as a proxy for the British Government dollar borrowing rate, since the dollar is the most liquid sovereign debt market, and a British Government dollar loan rate was not immediately available (although it could be calculated). This risk premium applies to the total amount guaranteed by the ECGD in respect of each foreign government over each year the loan is outstanding.

We identified the total amounts at risk (£17,100m at 31 March 1999, of which 24%, or £4,100m, was defence-related). We estimated an aggregate market risk premium of 5% by noting that typical medium term emerging market bond risk premia were at that time between 1.8% for China to 8% for Brazil. It should be noted that ECGD credit exposure is on long term contracts to areas of high political risk, so the actual figure would be well above the middle of the range. With more information available in the latest ECGD Annual Report it is now possible to make a better estimate of the market risk premium for each guarantee, though to do this accurately would require information on the repayment profile of each guaranteed loan – information not presently made available publicly by ECGD.

From this gross cost of £205m we deducted the premium income received from companies of £22m (average over last ten years), added £41m for contract risk (see above), and added an additional interest rate subsidy (averaged over last ten years at £3m), to arrive at a figure of £227m for ECGD subsidies. In the light of ongoing research we are convinced this estimate is conservative.

To the extent that the ECGD covers interest rate and foreign exchange rate risk, equivalent instruments are readily available in the derivatives market. The ECGD itself now lays off much of its risk in these areas via established derivatives markets.

There is also an additional market that is fast developing that challenges the remaining function of the ECGD. The credit derivatives market is a market for corporate and sovereign risk, and is growing rapidly.¹⁷ It is a highly flexible market, and though young, has many options for customers seeking to hedge their risks.¹⁸ The pricing of credit derivatives is based primarily on bond yield spreads – the

¹⁷ Morgan Stanley estimate the CD market to be just under \$1 trillion as at mid-2002, "Spotlight, Credit Derivatives" in *The Treasurer*, May 2002, p. 45. The 1999 KPMG report for ECGD (para 4.7.6) and The Treasury itself identified credit derivatives market as a potential method of ECGD hedging its risk in the market .

¹⁸ Frost, J., "Corporate Uses for Credit Derivatives", in *International Treasurer*, 31 March 1997, <http://www.intltreasurer.com/corpcder.htm>. "Like other derivatives, credit derivatives are very flexible financial contracts in that their payouts can be derived from loan or bond values, default or credit events, credit spreads, or credit ratings. These reference assets, in turn, can be associated with single names, baskets or indices with cash settlement or physical delivery of a relevant underlying asset or portfolio of assets." See also Davies, J., Hewer, J., Rivett, P., *The Financial Jungle - A User Guide to Credit Derivatives*, (2001, PriceWaterhouseCoopers, London).

same method as above, though like other derivatives, credit derivatives are very flexible financial contracts in that their payouts can be derived from loan or bond values, default or credit events, credit spreads, or credit ratings.¹⁹ These reference assets, in turn, can be associated with single names, baskets or indices with cash settlement or physical delivery of a relevant underlying asset or portfolio of assets. Indeed in a recent article the use of credit derivatives to cover sovereign risk was explicitly addressed.²⁰ Has the time come for the ECGD to re-insure its sovereign risk exposure via these markets? To do so would make explicit for all to see the true quantum of the subsidy it gives.

It has been said that ECGD is involved in supporting markets that the private financial markets are unwilling to cover. This is true, though for a minority of ECGD guarantees. The reason private financial markets are undeveloped in these areas is because the risk is judged too high to give a price that would both be acceptable to the exporter or recipient government on the one hand, and adequately cover the risk on the other. This does not in itself indicate a market failure, so much as a market where demand at the market price is close to zero. In such circumstances, the government may be justified in intervening to create a market if it judges there are political or social reasons for doing so; but it must be recognised that these are not economic reasons.

What is the cost of these guarantees to the British Government?

Can the British Government beat the international bond markets? If the Government has access to privileged information enabling it to reduce the risk faced on such transactions below that faced by the market, then such information would also enable it to profitably exploit such a position by speculative trading in the international bond market (or indeed in credit derivatives). We consider this possibility to be conceptually problematic, runs counter to the prevailing economic policies pursued by this and previous governments, and would have far-reaching consequences for much of public sector finances (not to mention economics theory). Indeed, current government policy (such as Private Finance Initiatives, Public-Private Partnerships and the like)²¹ is moving in the opposite direction, apparently based on the belief that the private sector is the best vehicle to finance many areas of the domestic public sector such as health, housing and transport, where government control is so much greater. If it is appropriate to involve the private sector in these operations, why is it appropriate for the public sector to be engaged in guaranteeing private sector (arms trading) operations?

Would the removal of such implicit subsidy benefit the Government? As the ultimate guarantor of such debts, the Government pays for such subsidies by an incremental deterioration in its debt rating with the markets. This cost is currently 'hidden' across the full spectrum of Government borrowing, but the principle is well established.²² The total cost to the exchequer of such subsidies can only be reliably estimated using a market benchmark approach such as the one we propose.

Neither subsidy calculation accounts for severe or catastrophic risk, presently covered by the policies issued by ECGD and ultimately born by the Treasury. The possibility of extensive sovereign default by recipient states is real because the ability to pay for imports is closely linked to the health of the regional and global economy. That is, the risks are not independent. The 1999 economic crisis in south east Asia ripped through the region causing stock market crashes and extensive defaults. Debt repayments were rescheduled, but the default consequences have yet to run through the financial system. ECGD has not yet written off many of the debts that are inevitably uncollectible. A deeper crisis at a global level would present the sort catastrophic event that would lead to massive losses by ECGD and the Treasury.

K-values certainly do not account for catastrophic risk, but then neither does our market-based model. Facing a catastrophic event, a private insurance company always has the option to declare bankruptcy. Existing subsidy calculations will therefore underestimate subsidies arising from existing policies, unless those policies are altered to exclude such catastrophic events.

¹⁹ "Spotlight, Credit Derivatives" in *The Treasurer*, May 2002 p. 49.

²⁰ "Spotlight, Credit Derivatives" in *The Treasurer*, May 2002, p. 53.

²¹ It may or may not be accidental that the one common theme that the ECGD has with such schemes is that they enable the Government to receive monies now (whether capital sums or insurance premia) in return for a promise to return significant resources to the private sector at a later date.

²² In a similar vein, central Government restricts the capacity of local authorities and other debt issuing apparently independent organs of government to raise debt. And finance lecturers will be well versed in responding to the old chestnut 'why not use the cost of debt to evaluate a project if the corporate chooses to use debt to finance a new project'.

Such an exclusion is unlikely, as the whole banking system depends upon government guarantees against bankruptcy. The banking sector anticipates that the government is likely to bail out individual UK banks rather than see them go under, allowing them to accept higher risks than they would otherwise contemplate. This phenomenon, termed 'moral hazard', is well known. Because this moral hazard involves support for exports, it entails a subsidy of risk that ultimately benefits exporters and their customers. It is difficult to even guess at the impact, and we have not attempted to include it, further implying that our method underestimates the subsidies involved.

Who benefits and loses from these subsidies?

We believe it to be economically axiomatic that subsidies can be justified when they effectively negate market failure (i.e. where there are externalities,²³ or where the market is inefficient²⁴), or for social or political reasons.²⁵

Between a third and a half of ECGD guarantees are made to the defence industry.²⁶ Most ECGD guarantees are made directly or indirectly to larger exporters in the business, in order to minimise administrative costs. Guarantees are generally granted to a small number of the largest companies that are well connected and established. It would appear unlikely that the beneficiaries of ECGD guarantees are organisations worthy of government business support on economic grounds. Of course smaller subcontractors do benefit indirectly from larger deals, but very much at the whim and control of the prime contractor, who is able to determine the terms and conditions, and achieve much of the profit.

Market distortions harm other businesses and alternative industries that do not receive subsidies, through greater competition for investment, skilled labour and other inputs, and from worse terms of trade. The overall cost to British industry in terms of reduced productivity and competitiveness from this distortion could be considerable, but are conceptually difficult to quantify. The market distortion implied by the Government using its balance sheet to guarantee overseas sovereign debt is also likely to come at an economic efficiency cost greater than simply the incremental borrowing rate.

Who benefits from this system other than the UK arms supplier? The overseas recipient and the UK bank are other parties that may obtain an economic benefit. The UK Bank clearly receives a loan markup at negligible risk.

What is the impact of ECGD activities on the recipient? The effects on the social and environmental fabric of large construction projects or arms supply is well documented elsewhere. The economic impacts of foreign direct investment crowding out domestic investment or industry development can also be significant. It is highly questionable whether the sorts of activity supported by ECGD helps or hinders the government's objectives pursued by DfID in trying to deliver sustainable economic development based upon the nurturing of domestic industries. ECGD now takes into account issues of sustainable development in considering projects, at least partially, unless they involve defence contracts. Defence contracts only scrutiny is through the formal DTI arms export licensing system.

Conclusion

ECGD is pricing its products at well below the market level (as measured by market sovereign risk premia). This may be because of competing subsidies by other ECA. However, the existence of a competitive market between governments in the provision of subsidies is not an argument for subsidy itself. Such a subsidy can only be justified on explicit political or social grounds.

If there were no subsidy, there would be no reason for the Government to maintain ownership of the organisation, and proceedings ought to be commenced to privatise operations. Indeed if the prime reason for the continued existence of the ECGD is economic, thought could be given to providing explicit subsidies to existing international banks to continue the role. This would at least have the benefit of transparency.

Choosing where to allocate scarce Government resources is a political decision. However, the allocation of resources is frequently based upon prejudice and lobbying by interest groups rather than

²³ Many externalities are of course social or political in nature.

²⁴ For example, due to inequalities in market power, market information or market depth.

²⁵ for example, as part of a regional regeneration effort.

²⁶ See ECGD recent Annual Reports, where a breakdown is given on the proportion of business that is defence-related.

informed advice to ministers. As numerous government statements in the House concerning the financing of the Defence Exports Services Organisation within the MoD demonstrate, Government policy to support the defence industry has in the past been based, at least in part, upon the assumption that this support brings financial benefit to the Exchequer, largely through reduced prices for MoD procurement from British companies. Support by ECGD for exports, defence and civil, has been based on the assumption that the cost to the taxpayer is minimal, while the benefit to the economy is significant. Why else would this business have been retained within Government when the short end of the business was privatised in the early 1990s? *Economic Colonialism* may go some way to explaining it.

Appendix: NERA 2000 conclusion (in full, emphasis added)²⁷

The objective of this study has been to review the economic rationale for the public provision of export credit insurance and guarantees. In carrying out this remit, we have in effect analysed two separate hypotheses. The first hypothesis is that it is efficient for ECGD to provide EXIG. The second hypothesis is that it is efficient for EXIG to be provided to exporters at subsidised rates.

*The arguments in favour of the first hypothesis are relatively strong. The advantages available to ECGD as a government institution, and the reputation it has succeeded in establishing, suggest that it is currently likely to be a more efficient provider of EXIG than an alternative private sector operator. **However, we cannot definitively determine whether ECGD is indeed the most efficient provider of EXIG until it competes on equal terms with the private sector. This will only occur when subsidies contained in its premium rates are eliminated.***

*The various justifications for these subsidies (that they meet aid-related, industrial policy and employment objectives) are weak. The only constraint on raising ECGD's premium rates is the fact that adjustment costs will be incurred if ECGD does so and other ECAs do not follow suit. For this reason, **we would recommend attempting to secure support for a multilateral increase in premium rates.** Further quantitative analysis may be useful in establishing how long such negotiations should be continued before raising rates unilaterally.*

***If all subsidies are eliminated, one of three scenarios is possible.** Customers may still wish to use ECGD's services and private sector entry may be minimal. This would imply that ECGD is able to provide cover at lower cost than alternative private sector operators, and that the efficiency arguments of Chapter 4 are vindicated. Alternatively, private sector operators may begin to take over future business, which would imply that the only advantage ECGD currently has is the subsidy included in premium rates. A final possibility is that the current level of business might not be sustainable without subsidisation, and resources will be diverted elsewhere.*

In all of these cases, efficiency will have been improved relative to the status quo.

²⁷ Estrin, S., Powell, S., Bagci, P., Thornton, S., Goate, P., *The Economic Rationale for the Public Provision of Export Credit Insurance by ECGD*, (2000, National Economic Research Associates, London) Cmd Paper 4791; available on the ECGD website at: <http://www.ecgd.gov.uk/nera.pdf>. Section 9: Conclusion.