OPM 513/68

No. 1263B

Memo by the Prime Minister
Financial Assistance Agreement with Germany

Following consideration by Ministers of Memo 1263A it was agreed in Cabinet on 18th November, 1969 that further enquiries should be made with the German Ambassador to establish the precise terms of the proposed loan.

2. The German Government was duly approached. On the 6th of January the German Ambassador gave an outline of the sort of terms we might expect to get: (a) It would most likely be a 20-25 year loan, with a period of grace before the first payment becomes due: (b) the rate of interest would probably be somewhere within the range of 4 to 5½%; and (c) the German loan would not be tied to imports from Germany. These were no more than broad indicators but they did serve to give us some idea of the sort of loan they were prepared to make available.

The annexed correspondence (Appendices A, B and C) shows that there are conflicting views between the Ministry of Finance and the Economic Planning Division of the Prime Minister's office regarding the acceptance of the loan. The difference of opinion is now being put to Ministers. Ministers are accordingly asked to decide whether

a) the German offer should be declined or
b) it should be accepted, apart from other considerations, in order not to prejudice our chances of obtaining aid from Germany in the future.

16 APR 1970

App 'A'

OFFICE OF THE PRIME MINISTER,
AUBERGE D'ARAGON,
VALLETTA,
MALTA.

OPM/513/68

MFCP/331/67

4th February, 1970.

Secretary,
Ministry of Finance,
Customs and Port

Financial Assistance from Germany

... I enclose copy of Note Verbale dated 6th January, 1970, from the German Ambassador in connection with the offer of a soft loan of 2 million D.M. (£226,000).

The German Government has been pressing us to take up the loan offered for 1969/70 and has now agreed to carry it over to 1970/71. If we are to take up the offer it is important that the loan should be utilised next financial year. It has been diplomatically hinted that, if we do so, there is every likelihood that further loans would be forthcoming during the currency of the Third Plan. The terms of the offer are tempting. The repayment period has been set at 20/25 years, the rate of interest at 4/5½%, and the loan would not be tied to German imports.

It is our view that this loan can be used to Finance the Gozo Industrial Estate. The German Government has already been interested in this project and has proposed how we should go about obtaining approval (vide ... note attached). This means we are in a position to put in a request as soon as we choose to do so.

The factory programme has so far been financed from U.K. Exchequer loans repayable over 25 years at an excessively high interest rate(currently 9%) and tied to offshore procurement from U.K. As the German offer is for a comparable repayment period at a much lower rate of interest and is not tied to German imports, it would be economically advantageous to shift from U.K. to German financing. It would also pave the way for us to devote future loans from Germany to factory projects in Malta or Gozo. An alternative would be to finance the Gozo distiller for which we have failed to obtain U.K. finance.

If you agree that the offer should be accepted and the loan sought specifically for the Gozo Industrial Estate, with the Gozo distiller as a second choice, you may wish to put up a memorandum for consideration by Cabinet.

(G. BORG CARDONA),
f/Administrative Secretary.

App. 'B'

MFCP/331/67

Ministry of Finance, Customs
& Port,
The Palace,
Valletta - Malta.

10th March, 1970.

Administrative Secretary

Financial Assistance from Germany

Please refer to your letter OPM/513/68 of the 4th February, 1970.

2. It is felt that one has to view the German offer for financial assistance in the light of our requirements and of the facilities we have to meet those requirements. In this we have to be guided by the programme envisaged in the draft Third Year Plan which for Public(Government) investment provides for £45 million. Of this £5 million are expected to remain unspent while £21.2 million should be available from the U.K., leaving £18.8 million to be raised from other sources. If the balance of £18:8 million is raised locally as assumed in the draft plan, it would on average mean £3.76 million per annum (or £4.84 million if the financing requirements of the Drydocks and Electricity Board are included) which does not look an impossible figure provided we go about it in a proper manner. Looked at in this light we cannot really say that we need the meagre sum of £0.2 million from the German Government, particularly as U.K. aid should provide us with substantial foreign currency for the import requirements of our investment programme.

3. The above assumes of course that U.K. aid will in fact be forthcoming and I do not think we can do otherwise but go by that assumption. Admittedly the rate of interest on U.K. loans is higher than that proposed for the German loan (4/5½%) but it does not really look as if we can shift from U.K. to German financing as indicated in paragraph 4 of your letter. Assuming a ratio of 75% grant and 25% loan, for every £100 loan from U.K. substituted by a German loan we lose £300 by way of grant or £100 grant if the ratio is 50/50. Moreover we would still have to incur the cost of raising further loans to substitute the amount lost by way of grant. If the argument is that we should substitute U.K. aid by a German loan, the result would still be unfavourable since for every £100 by way of a German loan we would be losing £75 (or £50) by way of grant. It would not therefore seem as if we could really shift from U.K. to German financing.

4. What we can do is to shift from local loan to German loan. Admittedly at the moment it is not possible to raise local loans for less than 5½% but on the other hand if we take up the German offer we will be tied to this rate for 20/25 years. Furthermore the terms proposed are not at all firm and will depend on a report by the German Credit Bank for Reconstruction and we do not know what criteria this bank will use. What is more important however is that unless there are more cogent reasons to prefer the German loan, we should opt for local borrowing since this would ensure that the servicing payments do not go out of our Income stream. Of the two projects mentioned in your letter, the Gozo distiller seems to have been already ruled out by the Germans (see the Note Verbale of the 4th September by the German Embassy attached to Commonwealth and Foreign Affairs letter of the 10th September, 1969). As regards factory projects, I think it is safe to assume that the bulk of the expense is local costs and it is not therefore a question of finding any necessary foreign currency but merely of financing which, as already stated, could be met from local borrowing.

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5. Perhaps a possible advantage arising from the German loan lies in the fact that contacts with a financial centre of a leading industrial nation could indirectly bring in further contacts with industrialists and financiers who would be interested in investing privately in Malta. In a similar case, that of the Italian loan, it would not seem however that much was achieved in this line and in any case there are ot er ways, better and cheaper, to achieve this.

6. Apart from any economic considerations, there is further the point which is raised in paragraph 7 of the memo to Cabinet on Financial Aid from Germany, namely that Government to Government assistance can hardly be dissassociated from political strings. In this particular case the sum involved would not seem to make this risk worthwhile.

7. In view of what is stated above, it is felt that on balance it would not be worthwhile to take up the present German offer.

sd. (R. Soler)
Secretary.

App. 'C'

Minute 108 in File OPM/513/68

Administrative Secretary

You may wish to see reds 101 and 107.

2. Secretary, Ministry of Finance, Customs and Port appears to be arguing athat the German offer is not worth pursuing, on three main grounds: (a) we do not really need the meagre sum of £0.2 million; (b) we cannot shift from U.K. to German financing because this would involve a 'loss' of grant moneys from U.K. aid and (c) we should opt for local borrowing as this ensures that servicing payments are kept in our income stream.

3. In regard to (a) we are of course perfectly aware that such a relatively small sum is insignificant in the context of our overall investment requirements. We recommended the loan, however, on three counts: firstly on the assumption that every little helps: secondly because acceptance would enhance our chances of obtaining loans, possibly larger, in future years if the need should arise; thirdly because Secretary, Ministry of Commonwealth and Foreign Affairs has advised that failure to take up the loan this year could seriously prejudice our chances of aid from Germany in future.

4. With respect to (b) I would point out that factories are financed out of exchequer loans. Aid worthy projects are financed either by grant or loan but never by a mixture of both, so the grant/loan ratio is only relevant in the context of our total drawing of aid funds. Since British aid, whether grant or loan, would not, under best assumptions, finance all our requirements there can be no doubt that there will still be many projects on which to utilise the full amount due to us under the financial agreement. There is no question therefore of either British aid or the German loan: we can have both.

5. The argument at (c) is, I would suggest, of questionable validity. Assuming availability of finance from local sources I should have thought that whether or not there would be advantage in taking this money would depend on (1) the terms on which the finance is available, and (2) the opportunity cost of using the Maltese money for some other income generating purpose. In regard to (1) I would simply say that the German offer is soft whereas a local loan would not be; as for (2) I would say that Maltese money invested in industry (particularly export oriented) might well have a more beneficial total effect and even money posted into some other form of investment abroad would be better deployed if the investment led to a reverse flow into our income stream greater than the outward flow on German loan servicing. Moreover, the Finance thesis - taken to its logical conclusion - would appear to imply that foreign aid should come in grant form or not

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at all, because they do not think loan aid worth taking. I can think of circumstances where local loan finance might be preferable to a foreign loan but to put this forward as a general unqualified proposition seems to me to be going too far.

6. You may wish to agree that a reply in this sence should be returned to Finance, possibly over your signature.

21.3.70

sd.(P.G. STAINES)