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PRIME MINISTER

Export Credit Support for Vosper Thorneycroft

You have seen Mr. Tebbitt's letter of 7 March on the request for export credit support for the sale by Vospers of fast patrol craft to Kenya and frigates to Pakistan - Mr. Tebbitt said he would be prepared to support one but not both of these contracts, and that he preferred the Kenyan one. The Chief Secretary was also prepared, reluctantly, to go along with just the Kenyan contract.

The Foreign and Commonwealth Secretary in his letter to the Chief Secretary of 15 March continues to press the case for the Pakistan contract. In support of this, he quotes your letter of August 1982 to President Zia which said that the Vosper offer

"is, as I think you will know, backed by the British Government who have agreed to provide a significant proportion of the credit through the Export Credit Guarantee Department".

This might be thought to be binding, but since then the value of the contract has increased from £150 m to £220 m, and the degree of cover has gone up from 50% to between 70% and 100%.

The best course would be a meeting of OD or EX next week to settle two issues. We have been informed that President Moi intends to make his decision on Tuesday or Wednesday next week. A meeting after you return from Brussels could mean that the Kenyan contract would be lost which could leave us in the position of chasing the inferior Pakistan contract in order to support Vospers.

Although it would not please the Chief Secretary who sought to make his agreement to the Kenyan contract conditional on withdrawal

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of support for the Pakistan contract, you may want to agree to the Kenyan contract, and call for a meeting of OD or EX next week to discuss the Pakistan contract. This needs to be settled before the end of the month. Mr. Heseltine has not yet given a view on his choice. He may decide to press the Pakistan case, but he intends to talk to Mr. Tebbitt first, and having done so, may decide not to.

Agree the Kenyan contract and a meeting on Pakistan?

Yes

JT Yes

I think my letter to President
Zia must be honoured.

mt

16 March, 1984.



cc FCO
HMT
~~DIT~~
MOD
CO

10 DOWNING STREET

From the Private Secretary

19 March 1984

Export Credit Support for Vosper Thorneycroft

The Prime Minister has seen your Secretary of State's letter of 7 March to the Chief Secretary and the replies from the Chief Secretary on 12 March and the Foreign Secretary on 15 March. She takes the view that the request for export credit support for fast patrol craft for Kenya should be agreed but that a meeting of OD should be held to discuss the request for export credit support for frigates to Pakistan.

I am copying this letter to Private Secretaries to members of EX, Richard Mottram (Ministry of Defence) and Richard Hatfield (Cabinet Office).

Andrew Turnbull

Callum McCarthy Esq.
Department of Trade and Industry.

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cd



10 DOWNING STREET

A.J.C.

Chief Secretary has agreed to either the Kenyan or the Pakistan deal but not both, with a preference for the former

N Tebbat will accept just the Kenyan deal

Foreign Secretary argues for the Pakistan deal - ~~it's~~ as well, citing the Prime Minister's August 1982 letter. This looks pretty binding to me. What do you think?

AT

15/3

Mr. Turnbull.

I agree that the Prime Minister's letter is pretty binding. But it looks to me as though we should have a brief meeting of EX next week.

A.J.C. $\frac{16}{3}$



FCS/84/83

~~CC NO~~
2pp3

CHIEF SECRETARY TO THE TREASURY

1. In your letter to Norman Tebbit of 12 March about patrol boats for Kenya and frigates for Pakistan, you reluctantly agreed to ECGD cover for the sale of Vosper Thornycroft patrol boats to Kenya, providing that ECGD cover for Vosper Thornycroft frigates for Pakistan were withdrawn.

2. The background has been fully set out in earlier correspondence. I agree with Norman Tebbit that the economic, industrial and commercial aspects of the two cases face us with a difficult decision. I also acknowledge the strength of your points about the economic and market assessment of Kenya and Pakistan, the potentially expensive risk of default at a difficult time for ECGD, and the effect of cover for either order on the prospects of other British exporters in the markets concerned. These important prudential considerations are indeed discouraging, though I believe they need qualification. In the case of Pakistan her external position remains vulnerable, but it would be wrong to ignore the relatively high economic growth she has achieved over the last six years. In the case of Kenya, her reserves are at their highest level since the late 1970's; also, with one explainable exception, Kenya has not defaulted on commercial debt, as Malcolm Rifkind pointed out in his letter of 27 February.

3. But my chief point is a political one. I believe that the foreign policy implications are such that exceptions should be made in both cases. The arguments for Kenya were set out in Malcolm Rifkind's letter of 27 February and remain

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* PAKISTAN: MILITARY AID:
OCT 79

valid: the foreseeable damage to our relations with Kenya in reducing cover outweighs the commercial risks of granting it. Pakistan is more complex. The Prime Minister's support for Vosper's efforts in her letter to President Zia of August 1982 is an important factor. Although Vospers are now seeking increased cover, President Zia will no doubt expect us to stand by our support for Vosper. He told Janet Young on 11 March that once adequate financing had been arranged our bid would have priority. Given their clear preference to buy British, the Pakistanis would be surprised and disappointed if we now backed out of the project. Any decision to withdraw cover from Pakistan will of course need to take into account the Prime Minister's intervention with President Zia.

4. In short, while I accept the need to give full weight to the prudential considerations, I believe in this case that the balance of advantage lies in approving ECGD support for both the fast patrol boats for Kenya and the frigates for Pakistan, if necessary by reserving special cover outside normal limits in order to keep the market open to British exporters.

5. I am copying this minute to members of EX, Michael Heseltine, Norman Tebbit and Sir Robert Armstrong.


GEOFFREY HOWE

Foreign and Commonwealth Office
15 March 1984

Defence : Pt 4

Defence Sales

15 MAR 1964





JF6024

Secretary of State for Trade and Industry

DEPARTMENT OF TRADE AND INDUSTRY
1-19 VICTORIA STREET
LONDON SW1H 0ET

Telephone (Direct dialling) 01-215) 5422

GTN 215)

(Switchboard) 215 7877

15 March 1984

The Rt Hon Peter Rees QC MP
Chief Secretary
HM Treasury
Treasury Chambers
Parliament Street
LONDON
SW1P 3AG

D. Peter

EXPORT CREDIT SUPPORT FOR VOSPER THORNYCROFT

Thank you for your letter of 12 March. As I said in my letter of 7 March, I consider it is necessary from the industrial point of view, and with privatisation in prospect, that we should offer export credit support for either the Kenya or the Pakistan order. I am glad that you are able to agree to ECGD supporting the potential Kenyan sale on this basis.

2 As regards the withdrawal of the existing offer of cover for the potential Pakistan sale, this expires at the end of this month, so that all that will be needed is to inform Vospers and the Pakistan Navy that, regrettably, the offer cannot be renewed.

3 Further advice from our High Commissioner in Nairobi this week suggests that we need to move urgently to counter aggressive selling tactics by our competitors, notably the Italians. I hope, therefore, that colleagues can agree quickly that we should proceed on the basis set out above.

4 I am sending copies of this letter to other members of EX and to Michael Heseltine and Sir Robert Armstrong.

NORMAN TEBBIT

McFarlane
Sales N.Y.

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15 MAR 1964

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2. CF to await DTD
reps

AT 12/3



Treasury Chambers, Parliament Street, SW1P 3AG

Rt Hon Norman Tebbit MP
Secretary of State
Department of Trade & Industry
1 Victoria Street
LONDON
SW1E 6RB

12 March 1984

Dear Secretary of State,

EXPORT CREDIT SUPPORT FOR VOSPER THORNEYCROFT

Thank you for your letter of 7 March about Geoffre Pattie's requests for credit support for the sale by Vospers of fast patrol craft to Kenya and the increased cover for the sale of frigates to Pakistan. I have seen comments on the Kenyan case from Malcolm Rifkind.

The current economic and market assessment of both Pakistan and Kenya is such that there is no prudential justification for providing cover for either of these sales. Cover had originally been agreed for the original proposal for the sale of frigates to Pakistan mainly on industrial arguments. The same arguments, particularly the argument about the need to provide work for Vospers as a means of enhancing their privatisation prospects, apply equally to the Kenyan case. The latter does not seem a sufficient justification for taking on potentially expensive risks of default by two buyers at a time when ECGD's finances are under serious pressure and at the expense of other orders. I would therefore favour rejecting both proposals.

If however you judge that the impact of doing so would be to cast serious doubt on the whole future of Vospers I would, very reluctantly, be prepared to agree that ECGD should offer cover for one or other of these sales, though not both. Like you, I prefer the Kenyan order where the future market prospects seem better and the risk is smaller. But before agreeing to this we would need to be satisfied that the outstanding cover on the Pakistan deal can be withdrawn.

I am sending copies of this letter to other Members of EX and Michael Heseltine and Sir Robert Armstrong.

Yours Sincerely
Paul Rees

PETER REES
Approved by the Chief Secretary
and signed in his absence

DEFENCE : SALTS : Pt 4

1 3 MAR 1984





JF5915

Secretary of State for Trade and Industry

DEPARTMENT OF TRADE AND INDUSTRY
1-19 VICTORIA STREET
LONDON SW1H 0ET

Telephone (Direct dialling) 01-215 5422

GTN 215

(Switchboard) 215 7877

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7 March 1984

The Rt Hon Peter Rees QC MP
Chief Secretary
HM Treasury
Treasury Chambers
Parliament Street
LONDON
SW1P 3AG

Prime Minister.

You will wish to be aware, but
I suggest you await the view of the Chief
Secretary and others before intervening.

BF

mm

A.J.C. 1/3.

D. Peter.

EXPORT CREDIT SUPPORT FOR VOSPER THORNYCROFT

Geoffrey Pattie wrote to you on 8 February and to Paul Channon on 27 February to seek agreement for credit support for potential sales by Vosper Thornycroft to, respectively, Kenya and Pakistan. I understand that a decision is now needed very urgently on the Kenyan case, and that Vosper wish to present a revised credit offer to Pakistan this month. Both cases raise difficult issues, and we need to determine our overall approach in light of the conflicting considerations involved.

Kenya: Essential Facts

2 The latest proposal is for ECGD cover to be provided in support of an initial sale to the Kenyan Navy of two fast patrol boats worth £70m on terms which would give ECGD a Departmental maximum liability (DML) of about £105m. The Kenyan requirement is ultimately for four craft value £139m (DML £211m). France, Italy and Israel are now said to have made credit offers for the contract, so Vosper will lose their current position as the preferred supplier if the UK does not do likewise.

Pakistan: Essential Facts

3 In early 1982 Ministers agreed that 50 per cent ECGD cover should be provided on a contract value of £150m (giving a maximum DML of £110m) in support of the potential sale of two frigates to the Pakistan Navy; the rest of the credit was to be sought from Arab sources. The Prime Minister later wrote to President Zia referring to this



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offer and supporting Vosper's efforts. The contract value has now risen to £220m (as a result of an enhanced specification). The Pakistan Navy claims to have a comprehensive French offer for this, including 50 per cent Government backed credit. Vosper have now applied for increased credit on the enlarged order which would give ECGD a DML of between £217m and £250m; Vosper believe this would clinch the decision in their favour.

Industrial Considerations

4 Geoffrey Pattie's letters have explained the significance of these orders to Vosper. Apart from the potential sale of fast patrol boats to Egypt (for which a special reservation of ECGD cover has already been agreed), immediate export prospects are poor. With few exceptions, richer or more credit-worthy countries either manufacture their own vessels or are not at present in the market for new ones. Providing credit on orders such as these is thus essential if warship capacity is to be sustained. Without such export orders, the prospects of privatising Vosper (or at least the price likely to be obtained) will be adversely affected.

5 There is a particularly strong industrial case for the Kenyan order. The craft are of the type that Vosper have successfully exported in the past, and for which there should be a significant market in the future. Accepting the Kenya order would preserve employment at Vosper's Portchester yard (otherwise some 300 jobs will be lost), and the presence of the order would provide a very useful fillip to privatisation prospects. It is relevant that about 60 per cent of the Kenyan order would comprise defence equipment rather than the vessels themselves. We expect the manufacturers of such equipment to be among those interested in purchasing the yard, if its prospects are sufficiently promising.

6 The Pakistan order is more difficult, and if it were possible it would be helpful to defer the decision until we have decided the detailed approach to warship privatisation and had discussions with potential purchasers. On the one hand Vosper not taking the Pakistan order might help to solve the problem of overcapacity in steel warshipbuilding, since its loss must mean the closure of the steel building facility. However, the Woolston yard is not the yard where we would most like to see such capacity lost, and the presence of the order would provide a very useful dowry for its purchaser on privatisation. The closure of this facility would also necessarily mean the loss of many of the 2,000 jobs which it now provides.



ECGD Aspects

7 ECGD are concerned that the potential exposure on both the Kenya and Pakistan orders would be beyond what can be justified by the economic circumstances of those countries. To agree credit would, therefore, be outside the Chancellor's guidelines agreed by Ministers in 1982. ECGD have already, in providing a special reservation of cover for defence sales in Egypt and the existing offer of support for the Pakistan frigate order, given support to Vosper's export efforts beyond the limits they would consider prudent solely in the light of the strength of those economies. The proposal to accept increased exposure on the Pakistan economy is difficult. The proposed increase in the Kenya limit involved in covering two patrol boats value £70m also goes beyond what the ECGD would regard as prudent in the current circumstances of that country's economy. However, as between the two on balance ECGD takes a rather less gloomy view of Kenya than Pakistan.

Other Trade Considerations

8 Provision of cover for either order would damage the prospects in the markets concerned for other sales requiring medium or long term credit support for the foreseeable future. This threatens the position of long established exporters. This is a particular problem at present in relation to Pakistan where the present reservation for frigates is already adversely affecting British exporters' prospects of obtaining civil orders; we can expect representations if this market is effectively closed by the frigate order. A possible approach is to reserve special cover for the warship orders outside normal limits, leaving some, albeit restricted, scope for other sales, but this would, of course, make the ECGD exposure problem even worse.

Conclusion

9 On industrial grounds I would wish to support Vosper in obtaining at least one of these orders. However I realise that the allocation of ECGD cover on markets of such limited credit-worthiness would inevitably prevent ECGD support being given for other export to these markets. If my colleagues agree, therefore, I would recommend that support be given for either the Pakistan or the Kenya sale but not both and for the reasons set out above I consider the latter marginally the better case.

10 In view of the urgency of the Kenya case, a discussion may be necessary.



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11 I am copying this to members of EX, to Michael Heseltine and to Sir Robert Armstrong.

Norman

NORMAN TEBBIT

DEFENSE
Sales R4

8 MAR 1984

