



Ref. A084/2900

PRIME MINISTER

Tornados for Turkey

FLAG A

(C(84) 31)

## BACKGROUND

At the meeting of the Defence and Overseas Policy Committee (OD) on 22 October, members of the Committee present considered that the risks involved in offering the credit required to achieve the prospective sale of Tornados to Turkey were too great to be acceptable. As the Foreign and Commonwealth Secretary, the Secretary of State for Defence and the Secretary of State for Trade and Industry had advised in favour of the terms of the sale proposed but were unable to be present at OD, you concluded that the matter should be referred for consideration by the Cabinet.

2. In his memorandum C(84) 31 dated 30 October, the Minister for Trade has, with the agreement of the Secretary of State for Trade and Industry, brought forward revised British Aerospace (BAe) proposals for this prospective order and has again recommended that ECGD credit support should be given, even though the level required is well in excess of the agreed exposure limit for Turkey. The principal new factors set out in the paper are that BAe have indicated that Turkey is willing to increase the proportion of the sale price paid in cash to 25 per cent, an increase of 10 per cent on the proposal reported to OD; that industry and the commercial banks would be prepared to fund 70 per cent of the reduced level of credit support required, so cutting the level of ECGD credit liability needed from £344 million to £228 million; and that with the labour forces of sub-contractors taken into account, the employment created by the order would rise to a peak of 10,000 jobs, including the 500 at BAe (Warton) considered at OD. At the same time the credit available within the agreed limit for Turkey has been reduced from £80 million to £30 million by a recent Airbus contract.



3. The Minister for Trade will represent the Secretary of State for Trade and Industry for this item of Cabinet business.

#### HANDLING

4. You should invite the Minister for Trade to introduce his memorandum. You might then invite the Foreign and Commonwealth Secretary and the Secretary of State for Defence to state their views given their enforced absence from OD last week. You may wish to invite the Secretary of State for Employment and the Minister without Portfolio to advise on employment aspects. The Chancellor of the Exchequer should be invited to comment on the revised credit proposals set out in the Minister for Trade's memorandum. The strategic importance of the order and its significance, as regards the creation of employment within the United Kingdom, will no doubt be accepted by the Cabinet and therefore you may wish to concentrate discussion on the issues which were in dispute at the recent OD meeting:-

(a) Impact of the order on future sales prospects

At OD the Chancellor of the Exchequer took the view that there was little prospect of further sales of Tornado. The Minister for Trade in his memorandum on the other hand holds out prospects of further sales in the Middle East and the Far East. How important would a breakthrough in achieving the first export order of Tornado be in terms of achieving foreign sales? The Minister for Trade, the Secretary of State for Defence and the Chancellor of the Exchequer should be invited to comment.

(b) Credibility of the British Aerospace proposal

Is it realistic to suppose that Turkey can afford to pay 25 per cent of the sale price in cash (£246 million)? Will industry and the commercial banks realistically be able to find 70 per cent of the credit required? At OD the



Chancellor of the Exchequer was extremely pessimistic about the ability of industry and the banks to meet such a large credit demand, given the probability of a further rescheduling of Turkish debts and Turkey's past record. Is there a possibility that industry and the commercial banks might withdraw at a later stage, leaving a difficult financial position with pressure on the Government to step in with further credit support? The Minister for Trade, the Secretary of State for Defence and the Chancellor of the Exchequer should advise.

(c) The maximum acceptable level of ECGD liability

Given the importance of this order in strategic and job opportunity terms, is it realistic to restrict the ECGD exposure to £30 million? With such important national interests at stake can this limit be increased somewhat without recourse to the direction of the ECGD Accounting Officer and the action with Parliament which this would imply? Can the difference between an acceptable level of ECGD liability and the remaining credit required be made up by industry or by some other means, eg military aid by the three Governments involved to reflect the importance of positioning Tornado infrastructure on the southern flank? The Chancellor of the Exchequer and the Secretary of State for Defence should be invited to advise.

CONCLUSION

5. Subject to the view taken in discussion of the viability of these proposals, given the state of the Turkish economy, you could guide the Cabinet to decide whether the revised BAe proposals are acceptable and what the division of credit exposure should be between public and private sector sources.

A handwritten signature in black ink, appearing to read 'R.A.' or 'R.A.' with a stylized flourish.

ROBERT ARMSTRONG

31 October 1984

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PRIME MINISTER

31 October 1984

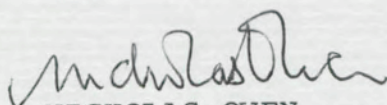
TORNADOS FOR TURKEY

BAe have now reduced their request for ECGD cover by over £100 million. This illustrates the value of holding back on requests of this kind.

It would be unwise to count on Turkey making any payments on this project before 1990. The IMF have declined to sign a stand-by credit agreement - a kind of certificate for good health. Turkey relies entirely on new borrowing to repay interest and capital on existing, and new credits. This is likely to continue to be the position to 1988, at least, on any of a range of IMF scenarios. Turkey's outstanding debt (\$20b) is not expected to decline.

Recommendation

If the sentiment in Cabinet is strongly in favour of ECGD cover for the order, at the expense of civil exports to Turkey, we suggest that as a condition for the cover BAe should be invited to negotiate an excess-risk premium with ECGD. The project could easily carry this. The price is well padded; the R&D overheads written off. ECGD need the extra income, to avoid penalising other exporters, or touching the taxpayer for more (£500 million this year).

  
NICHOLAS OWEN

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Tornados for Turkey

You may like to see, in advance of Cabinet, the revised paper circulated by Paul Channon.

The differences compared with the OD paper are:

- the contract value and the UK share remain the same (£985 million and 58%);
- but the Turks are prepared to increase the cash payment from 15% to 25%;
- the total credit requirement has come down by £100 million (£837 million to £739 million) as has total exposure;
- ECGD's share comes down from 40% (£344 million) to 30% (£288 million) because the banks/suppliers are prepared to take a higher share.

But it would still be necessary to withdraw cover for civil business, unless the risk is taken elsewhere than on ECGD's trading account.

C.D.P.

C. D. POWELL  
30 October, 1984

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3 copies

THE RT. HON. MARGARET THATCHER, M.P. PRIME MINISTER

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THE RT. HON. MICHAEL HESELTINE, M.P. MOD  
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U R G E N T  
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SALE OF TORNADO AIRCRAFT TO TURKEY  
PROVISION OF E.C.G.D. COVER  
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I UNDERSTAND THAT A CABINET DECISION IS IMMINENT CONCERNING E.C.G.D. COVER FOR THE PROPOSED SALE OF TORNADO AIRCRAFT TO TURKEY. AS CHAIRMAN OF FLIGHT REFUELLING (HOLDINGS) PLC I WOULD LIKE TO EMPHASISE THE IMPORTANCE THE COMPANY ATTACHES TO THE ACHIEVEMENT OF THIS SALE.

THIS PROJECT OFFERS THE FLIGHT REFUELLING GROUP A SIGNIFICANT OPPORTUNITY BOTH IN TERMS OF WORKLOAD (100 MAN YEARS) AND ENTRY INTO A NEW OVERSEAS MARKET. IT COULD REPRESENT APPROXIMATELY A 5% GROWTH IN EMPLOYMENT PROSPECTS WITHIN THE F.R. GROUP.

FLIGHT REFUELLING WILL RESPOND COMPETITIVELY BUT YOUR HELP IN ACHIEVING A POSITIVE RESPONSE FROM E.C.G.D. IS WE FEEL ALL IMPORTANT.

M.J. COBHAM

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OCTOBER 1984/REF 1315/20

ATTN OF THE RT. HON. MARGARET THATCHER, MP,  
PRIME MINISTER.

COPY TO THE RT. HON. MICHAEL HESELTINE, MP,  
SECRETARY OF STATE FOR DEFENCE,  
MINISTRY OF DEFENCE.

THE RT. HON. PAUL CHANNON, MP,  
MINISTER FOR TRADE,  
DEPARTMENT OF TRADE AND INDUSTRY.

THE RT. HON. TOM KING, MP,  
SECRETARY OF STATE FOR EMPLOYMENT,  
DEPARTMENT OF EMPLOYMENT.

THE EMPLOYMENT IMPLICATIONS OF THE SALE OF AN EXTRA 40 TORNADOS  
TO TURKEY WILL REPRESENT TWO YEARS' WORK FOR 150 MEN WITHIN  
DOWTY FACTORIES. WE WOULD ALSO PROVIDE ANOTHER 150 JOBS AT  
OUR SUB-CONTRACTORS. CONSIDERABLE SPARES AND SUPPORT BUSINESS  
WOULD BE GENERATED FOR THE FUTURE.

M. H. SPENCE,  
MANAGING DIRECTOR -  
AEROSPACE AND DEFENCE DIVISION,  
DOWTY GROUP PLC

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