

PRIME MINISTER

FRIGATES FOR PAKISTAN

The problem of credit for the sale of three frigates to Pakistan has re-emerged, with the Pakistanis pressing us to find an extra £30 million of Government-supported credit to make sure of the contract. The currently agreed Departmental Maximum Liability is £215 million. There are rumours, but no hard evidence, of rival offers from the French and Germans.

A&B. The MOD and the FCO want to meet the Pakistani's wish basically on political grounds of support for General Zia.

C. The DTI are not enthusiastic but are prepared to go along. They point out the good industrial and employment arguments for supporting Vosper Thornycroft, and enhancing the prospect of privatisation.

D. The Treasury are firmly opposed. Our potential exposure on the sale is already more than is prudent, and the state of the Pakistani economy has worsened since the original decision was taken. They argue that we should revert to the two ship deal originally proposed, and offer to look again at a third ship at a later date (though the Pakistanis are adamant that they want three).

/E

E The Policy Unit agree.

The question is: are we prepared to do a bit extra (and we've already gone a long way) to support General Zia and contribute to the viability of Vosper Thorneycroft? Or should we call his bluff on alternative sources of supply and/or reduce the size of the order to two ships?

Do you want to take a view? Or ask the Lord President to chair a meeting to try to find a solution?

C.D.P.

Would you look at my private undertakings to President Zia? - Was it for 2 ships? me

10 December 1984

PRIME MINISTER

FRIGATES FOR PAKISTAN

You asked about your precise undertakings to President Zia.

You have written to him twice, in August 1982 and September 1984. Both letters are attached.

At the time of the 1982 letter, only two frigates were under consideration. You said that the credit financing "... is backed by the British Government, who have agreed to provide a significant proportion of the credit through the Export Credit Guarantee Department".

By the time of your September 1984 letter, three frigates were under consideration. You gave no specific commitment on credit. But the sentence: "I was naturally delighted to hear that on the basis of the technical and financial assistance that we have offered, your Ministry of Defence have issued a letter of intent ..." could be said to imply that our willingness to extend "a significant proportion of the credit" applied equally to the sale of three ships.

In OD in March this year, you described the political case for increased credit cover for Pakistan as overwhelming. You now have the agreement of the Minister of Trade, the Foreign Secretary and the Defence Secretary to a further increase. Only the Treasury have opposed. No other members of OD have commented.

In the circumstances you might rule in favour of increased credit.

Agree?

EDP

Yes not

11 December 1984

VC2ACY



10 DOWNING STREET

CC: CDLO
LPSO
MOD
LPO
HMT
LCO
CO
FCO
DTI
CS, HMT

From the Private Secretary

12 December 1984

Frigates to Pakistan

The Prime Minister has considered the Defence Secretary's letter of 19 November to the Minister of Trade, proposing that we should agree to find another £30m. worth of Government supported credit to make sure of the contract for three frigates for the Pakistan navy. She has also noted the comments by the Foreign Secretary, the Minister of Trade and the Chief Secretary.

The Prime Minister takes the view that her previous letters to President Zia amount to a firm undertaking to facilitate this contract and that the political case for helping Pakistan is very strong. She believes that we should agree to find the further credit required.

I am copying this letter to Richard Broadbent (Chief Secretary's Office), Callum McCarthy (Department of Trade and Industry), Peter Ricketts (Foreign and Commonwealth Office), to the Private Secretaries of other members of OD and to Sir Robert Armstrong.

Charles Powell

Richard Mottram Esq
Ministry of Defence.



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

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GTN 215

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JU627
From the Minister for Trade

20 December 1984

The Rt Hon Peter Rees QC MP
Chief Secretary
HM Treasury
Parliament Street
London SW1

*nb pm
Duk
20/12*

FRIGATES TO PAKISTAN

I have seen your letter of 10 December to Michael Heseltine and your subsequent minute of 13 December to the Prime Minister.

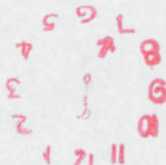
The issue of the extra cover for the frigates for Pakistan is now settled. Officials are still examining the possibility of new arrangements to allow export credit cover to be provided for major arms sales without damage to civil trade, following the remit from OD on 16 October. I cannot accept your conclusion that if contingent liabilities for such sales were to be transferred elsewhere (for example MOD) ECGD's limits would have to be reduced *pari passu*. The question whether there is a case for HMG to accept additional exposure on arms sales is one of the important issues we shall have to consider when officials report. I should still wish arrangements to be made which would allow cover for civil business in Pakistan to resume. But I accept that without such arrangements there is no scope for further civil business at present.

I am sending copies of this to the Prime Minister and other members of OD and to Sir Robert Armstrong.

PAUL CHANNON

Dejence RT4

Sves



20 DEC 1984



FROM: CHIEF SECRETARY
DATE: 13 December 1984

PRIME MINISTER

FRIGATES FOR PAKISTAN

I have seen Charles Powell's minute of 12 December recording your view that further credit should be provided to enable Pakistan to buy frigates from Vosper Thornycroft.

2 I accept the political imperative of supporting this sale. But as I mentioned when we last discussed this matter, our exposure on Pakistan is now excessive and there will therefore be no scope for further civil business in this market.

3 I am sending copies of this minute to Members of OD and to Sir Robert Armstrong.

PR

for PETER REES

[Approved by the Chief Secretary]

DEFENCE : Sales Pt4

174 DEC 1984

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MO 6/13

C.P.F.

PM already
agreed

NBPM.

CDP
- 12/12PRIME MINISTERFRIGATES FOR PAKISTAN with CDP

You will have seen Peter Rees' letter to me of 10th December following the previous responses from Geoffrey Howe and Paul Channon to my letter of 19th November.

2. I appreciate the difficulties which Peter Rees describes but, as he says, we have always recognised the political significance of this sale, and we are a long way down the road with the Pakistanis following on our previous decisions. Nor must we underestimate the importance of the exchanges between you and President Zia. As Geoffrey Howe has said: we have to follow this die once cast. And I too do not believe that we can withdraw now, especially as this further request for extra credit cover clearly comes from the top. We shall lay ourselves open to charges of bad faith and the political consequences could be very significant.

3. The Pakistanis have stuck with us even in the face of seductive offers from the French and a major push by Chancellor Kohl during his visit. But we cannot expect them to continue with us if we slap them in the face now. The Pakistani position seems to me to have been well set out by Mr Niaz Naik in the discussion with Antony Acland reported in Geoffrey Howe's minute.

4. It is true that the total increase to the Departmental Maximum Liability (DML) required in support of the deal is £45 million, but the new total credit proposal of £260 million is in fact only £10 million above the higher limit we agreed at OD last March. The £215 million that Peter Rees quotes is the lower end of the bracket we accepted then;



we have kept within this during the main negotiations even when an extra ship was added to the package, and the support now being proposed brings us back to the same proportion of government support as we originally accepted for the two ship package.

5. If we are to retain our credibility with Pakistan, I believe we must make available the extra £30 million of credit cover now requested.

6. I am sending copies of this minute to other members of OD and to Sir Robert Armstrong.

Huffs

Ministry of Defence
12th December 1984

REFERENCE
Sales
Part 4



12 DEC 1984





Treasury Chambers, Parliament Street, SW1P 3AG

Rt Hon Michael Heseltine MP
Secretary of State for Defence
Ministry of Defence
Main Building
Whitehall
London
SW1A 2HB

10 December 1984

Dear Secretary of State

FRIGATES FOR PAKISTAN

I have seen your letter of 19 ^{with CDP?} November to Paul Channon seeking agreement to an increase in ECGD's exposure on the proposed sale of frigates to Pakistan. I have also seen comments from Geoffrey Howe and from Paul Channon.

I cannot agree to any increase in our exposure on this sale. Even if I could I would see no reason why ECGD should cover the whole of the increase in the contract price when they were only covering a part of the original deal.

What is proposed, is a substantial increase in the cover we have exceptionally agreed should be made available for this sale. As Paul's letter makes clear, the increase now requested is £45 million rather than £10 million. In accepting the original amount of £215 million in respect of these frigates, we have already gone considerably further than would be prudent on this market. Since the OD discussion, the Pakistani economy has worsened. Their current account deficit has widened through a worsening of their trade balance and a reduction in migrants' remittances and a slow down in aid disbursements much of which, anyway, goes to meet the need of Afghani refugees. The basic problems of the Pakistani economy are reflected in their request that the additional finance now required should not be found from the commercial market since this would reduce their scope for other borrowings. This clearly recognises that they are at the limit of their borrowing powers and underlines the case against providing additional ECGD cover for these frigates, particularly as they will not enhance the ability of the Pakistani economy to service their debts.

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Cover was agreed for these frigates because of our political commitment to Pakistan which I accept remains. However that commitment was for only two frigates. The third, to be supplied in kit form and assembled in Pakistan, was included on the basis that it could be covered by the agreed £215 million ceiling on ECGD's exposure. As Nigel Lawson suggested in his letter of 10 August, if this cannot now be done we should revert to two ships with an offer to look again at the third at a later date.

Paul's final paragraph refers to the work being done at official level on handling large defence sales in doubtful markets. He suggests that one way forward may be for MOD to carry the relevant contingent liability themselves so as not to prejudice ECGD's support for other business. This suggestion does not however meet the real point that what must concern us is total HMG exposure in doubtful markets. If some of the contingent liabilities are transferred to MOD, ECGD's limits would have to be reduced pari passu. Changing the accounting treatment does not provide more scope for civil business in these uncertain markets.

I am sending copies of this letter to the Prime Minister, other Members of OD and to Sir Robert Armstrong.

Yours sincerely

P. Broadbent

for PETER REES

[Approved by the ^{Chief} Secretary]

10 DEC 1984

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DEPARTMENT OF TRADE AND INDUSTRY

1-19 VICTORIA STREET

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From the Minister for Trade

Rt Hon Michael Heseltine MP
 Secretary of State for Defence
 Ministry of Defence
 Main Building
 Whitehall
 LONDON SW1

cc/10

*Await Treasury
 views (pl ask
 for views by
 someone)*

6 December 1984 *(over)*

MB

New Secretary of State

FRIGATES FOR PAKISTAN

Thank you for your letter of 19 November in which you seek agreement to the increase in ECGD's DML to £260 million for the proposed sale by Vosper Thornycroft of three frigates to Pakistan. I have subsequently received a letter of 3 December from Geoffrey Howe advising that he would not challenge your request.

Your request raises difficult issues, which were discussed in OD in March. On the one hand there are good industrial and employment arguments for supporting Vosper Thornycroft. This order would serve to preserve Vospers' steel warship facility at Woolston, Southampton together with some 1,000 jobs. It would therefore enhance the prospects for privatisation. Vospers would continue to be well placed for export orders.

On the other hand, OD regarded its decision that ECGD cover should be increased to cover three frigates as exceptional, given the level of exposure required on a country with a limited capacity to pay. Following the OD decision ECGD agreed risk sharing arrangements with Vospers and their bankers on the basis of a DML of £215 million which was duly notified to all parties. Hence the increase in cover you are seeking is in reality £45 million, which is substantial in its own right.

However, if in the spirit of the basic decision to support this deal the Prime Minister and other Ministers are content to agree to your request as a final concession to secure the order, I would raise no objection.

However, the whole negotiation underlines the difficulty of handling these large defence deals in doubtful markets within ECGD's financial terms of reference. As you know, a working party of officials is examining the issue of the accounting treatment for major defence sales but this exercise is yet to be



Defence PT4
Sales

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completed. I do hope that a mechanism can be found for dealing with these cases without prejudicing ECGD's support for business - if necessary, by the MoD carrying the relevant contingent liability for defence sales which they themselves are promoting.

I am copying this letter to the Prime Minister and other members of OD and to Sir Robert Armstrong.

Yours sincerely
J. Nutter

for PAUL CHANNON
[approved by the Minister and signed
in his absence]

12 1 2 3 4 5 6 7 8 9 10 11 12

56
17 1984



FCS/84/318

MINISTER OF STATE FOR TRADE AND INDUSTRYCCNO
Await DTT ad TnyFrigates for Pakistan

1. Michael Heseltine wrote to you on 19 November about Vosper Thornycroft's efforts to sell frigates to the Pakestan Nay.
2. You should know that during official talks on 21 November between Antony Acland and his opposite number in the Pakistan Foreign Ministry, Mr Niaz Naik, the latter pressed the case forcefully for HMG agreeing to the £30 million additional credit requested by the Pakistan Navy for the sale of these three frigates. He said the Pakistan authorities were unable to increase the commercial credit element within the financial package now under discussion. This was because the Pakistan Government could not afford to increase their commercial exposure, which was already high as a result of commitments under their present 5 year plan. They therefore looked to HMG to provide the extra £30 million so that the contract could be concluded.
3. Naik stressed President Zia's personal involvement in the frigates deal saying that he had originally taken the decision in principle to offer the contract to Britain and had turned down a personal approach from President Mitterrand. President Zia wanted the Pakistan Navy to continue to have its main links with Britain. Other services, the Army and Air Force, had in recent years developed links with other countries, notably the United States. While there may be some element of bargaining in the Pakistan position as put forward by Naik the position as he explained it is plausible and we should, I believe pay proper attention to what he said.
4. As for the German interest, it is difficult to know how



for discussions between them and Palistan have gone but the signs are that Chancellor Kohl's recent visit to Pakistan made a considerable impact.

5. Negotiations for this contract would seem to be at an advanced, if not final, stage and it looks as if Britain may be near to clinching the sale. This is a big contract, and politically important for our relations with President Zia and the Pakistan Armed Services. I know that the Prime Minister (like myself) has from time to time been worried by the growing size of our bid (originally made in the aftermath of the Falklands campaign). But we have been persuaded that we have to follow the die, once cast. It was upon this basis that the Prime Minister again commended our bid to President Zia in warm terms on 30 September. Given his clear wish to buy British and the advantages that would flow from tying the Pakistan Navy to the UK, it would seem illogical and unwise to risk the contract now by attempting to call Pakistani bluff, if that is what it is. Sir Oliver Forster, who has just returned from Islamabad, shares this view. For these reasons I should not wish to challenge Michael Heseltine's request to make the necessary increase to ECGD's upper limit of DML for Pakistan.

6. I am copying this letter to the Prime Minister and other members of OD and to Sir Robert Armstrong.

GEOFFREY HOWE

Foreign and Commonwealth Office

3 December, 1984

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Sales

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PRIME MINISTER

23 November 1984

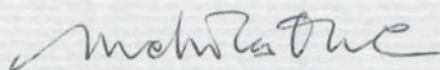
FRIGATES FOR PAKISTAN

Michael Heseltine's bid for an extra £30 million cover
ought to be resisted.

Having cheese-pared our programmes to hold public
expenditure to plan, at some political cost, how can we
countenance additional exposure in such a dodgy market?

Even if we had the money, we should not fall for this
salami tactic, without first having harder evidence about the
German package as a whole (price, terms, operational
attractions to the Pakistan Navy, local content). I
understand that the German frigate is a revolutionary concept,
which the German Navy has not adopted. How likely is it that
Pakistan will switch to an untried alternative in preference
to our frigates, whose architecture reflects the Royal Navy's
operating concepts, which are shared by the Pakistan Navy?

The point is made in the note that Pakistan is nervous
about fishing in the same pool as our commercial banks for
additional credit. This suggests that the market shares our
view about Pakistan's creditworthiness.


NICHOLAS OWEN

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cc:AO
NO might do a
minute

MINISTRY OF DEFENCE WHITEHALL LONDON SW1A 2HB

TELEPHONE 01-218 9000
DIRECT DIALLING 01-218 2111/3

MO 6/13

19th November 1984

Paul

Await views of
~~DTF~~ & Treasury
CDP 23/11

FRIGATES FOR PAKISTAN

I owe colleagues a progress report on our efforts to sell three Type 21 frigates to Pakistan, about which the Prime Minister last wrote to President Zia on 30th September. Negotiations have reached a critical stage, following the issue of a Letter of Intent to Vosper Thornycroft on 17th September. The Royal Navy has agreed to act as consultants to the Pakistan Ministry of Defence during the contract negotiations. But the question of credit has arisen once again, and is of particular importance since, following Chancellor Kohl's recent visit to Islamabad, the Germans have put in a much improved offer to support their bid.

You will recall that OD on 28th March agreed exceptionally to provide ECGD cover to a total value of £154 million, or about 70% of the then contract value (£220 million for two ships). OD accepted a Departmental Maximum Liability (DML) of between £217 million and £250 million for ECGD, but in all the risk-sharing arrangements so far proposed to the banks, the DML has not exceeded £215 million even though the Pakistanis have now increased their order to three ships. In early September Grindlays offered the Pakistanis a total credit package of £200 million available from both ECGD and commercial sources.

The Rt Hon Paul Channon MP

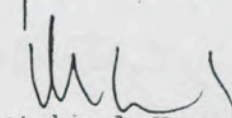


In the last round of technical discussions in October between Vosper and the Pakistani Ministry of Defence the full specifications of the ships were laid down, and the total contract value increased to £330 million, of which 93.5% is for wholly British equipment. The French, who appear to have fallen by the wayside, offered 80% credit, and the Germans have returned to the charge with 82%. Our current offer amounts to 61% (£200 million out of £330 million).

The Pakistanis have asked us to find another £30 million worth of government supported credit in order to make sure of the contract. They have assured HM Ambassador in Islamabad that although they will put up £100 million themselves, they can go no further, nor do they want Grindlays to go back to the commercial markets for any more than the £46 million already promised. I believe that there are good arguments for increasing our credit offer, especially since we need only increase by £10 million the upper limit of the DML already accepted by OD to accommodate the extra £30 million of credit to bring our offer back to nearly 70% of the contract value, as was the case in the package we originally agreed. ECGD, however, are so far resisting any increase in the DML beyond £215 million.

Having come so far, and with the Pakistanis saying that the contract must be signed in January, I believe that one last heave will land this deal. The long term benefits to our relations with the Pakistanis will be considerable; indeed, when we last discussed the subject in OD, it was agreed that the political case for agreeing the increased level of credit cover in support of the sale was overwhelming. Furthermore, the supply of British ships will have a beneficial spin-off in the Gulf and Saudi Arabia with whose navies the Pakistanis have very close links. I should therefore be grateful for your agreement to the necessary increase in ECGD's upper limit of DML.

I am sending copies of this letter to the Prime Minister, other members of OD and to Sir Robert Armstrong.

yes em

Michael Heseltine

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