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30 October 1984

CABINET

TORNADOS FOR TURKEY

Memorandum by the Minister of State, Department of Trade and Industry

THE ISSUE

British Aerospace (BAe) have a letter of Intent from the Turkish Ministry of Defence to supply 40 Tornado aircraft in the Royal Air Force (RAF) strike version to Turkey. The total contract value would be £985 million, split between the United Kingdom and its partners, West Germany and Italy. The United Kingdom share would be £573 million, including spares, training, ground support equipment and escalation.

2. The Turks are asking for long-term credit to finance a substantial part of the order. BAe have proposed that the United Kingdom share of the credit risk be shared between Her Majesty's Government, BAe and its sub-contractors, and the commercial banks. They have sought the British Government's support in the form of an Export Credits Guarantee Department (ECGD) guarantee. The Secretary of State for Trade and Industry's Department (ECGD) minutes (Annex D), attached, and the Secretary of State for Defence's minutes (OD) on 22 October, discussed at the Defence and Overseas Policy Committee (OD) on 22 October, set out the background. OD invited me to send a further paper to Cabinet. The Secretary of State for Trade and Industry is content for me to circulate this paper.

THE PROBLEM

3. Given the past history of debt rescheduling by Turkey, and uncertain prospects for the Turkish economy, ECGD cover for Turkey is very limited. Cover for new credit is underwritten under its Section 2 national interest account. Under the limits at present considered prudent, some £30 million of cover is available (assuming cover of about £50 million for last week's contract for seven Airbuses is agreed).

4. BAe's revised proposal on Tornado (see below) would involve ECGD exposure of £228 million. This is a substantial reduction on the potential exposure of £344 million considered by OD. But the new lower figure would still require a Ministerial direction to ECGD and a statement to Parliament.

## DISCUSSION IN OD

5. OD members recognised that there were important strategic and industrial arguments in favour of supporting this sale. They considered, however, that the credit risk involved and the consequent limitation on ECGD cover for potential civil orders, was too great to be acceptable.

## REVISED BAe PROPOSAL

6. BAe have now presented me with a revised proposal to reduce ECGD exposure on the sale, involving:

- a. an increase in the proportion to be paid in cash to 25 per cent;
- b. a reduction in the proportion of the credit to be guaranteed by ECGD from 40 to 30 per cent.

Details are at Annex A. The effect is to reduce requested ECGD exposure from £344 million to £228 million. United Kingdom content would remain the same.

## SIZE OF ORDER

7. BAe have, again, asked the Turks if they would be prepared to buy fewer aircraft (say 20) at least initially. The Turkish forces are firm that such an order would be unacceptable, because it would be uneconomic to provide the necessary full ground support to cover fewer planes. The Turks are, however, willing to increase the proportion paid in cash to 25 per cent.

## CONTRACT PRICE

8. The revised proposal involves no change in contract values which are regarded by BAe as firm and realistic. I understand that the Ministry of Defence shares this view. Contract values are based on a price per aircraft of \$19.7 million, which has been held since end-1983. To this has to be added two years' spares, training, ground support equipment and escalation.

## LIKELY ATTITUDE OF ITALY AND GERMANY

9. Past precedents on collaborative ventures indicate that other partners will fall in behind the lead partner in the provision of credit. The Secretary of State for Trade and Industry recently discussed the order with the Italian Minister of Industry and Commerce, who indicated that Italy would be able to provide support alongside its partners. The Ministry of Defence consider it is reasonable to expect that West Germany will come up with their share of the credit requirement.

PRIVATE SECTOR SHARE OF RISK

10. BAe have confirmed their willingness, with their principal sub-contractors, to take a substantial share of the credit risk, (up to 40 per cent depending on how much the banks take.) Their discussions with the clearing banks are continuing and I will report further to colleagues.

DIRECT FOLLOW-ON BUSINESS

11. a. Spares

Apart from the spares package included in the initial contract package, the United Kingdom would benefit from further spares sales broadly equivalent in value to the original contract, on cash terms, over the life of the aircraft.

b. Weapons

As this is an RAF configuration, there are good prospects for the sale of related weapon systems from the United Kingdom amounting up to £250 million, again on a cash basis.

OTHER SALES PROSPECTS

12. BAe believe that their current negotiations with Saudi Arabia for the sale of 20 Tornado aircraft would be materially assisted by an order from Turkey, given current bilateral defence discussions between the two countries on shared support and training. Equally, if the Turks order French Mirage 2000s, the French prospects in Saudi will be enhanced. Negotiations are also taking place on a sale to Oman. Longer-term prospects include Kuwait and the Far East.

EMPLOYMENT

13. This order will benefit some 65 sub-contractors as well as BAe. These firms (listed at Annex B) are widely distributed throughout the country. To maintain continuity of production following completion of deliveries to the RAF, an export order will be required early next year. Annex C illustrates that the Turkish order (including the expected direct follow-on business on weapons) would ensure the retention of significant employment throughout the industry from 1986 to 1990; this rises to a peak of 10,000 jobs in 1988-89. This includes an average of 500 jobs at BAe Wharton over the entire period.

ACCOUNTING TREATMENT AND IMPLICATIONS FOR OTHER BUSINESS IF COVER IS AGREED

14. Turkey has a good record on payment for military sales but if colleagues decide that support should be given for the Tornado sale cover for ordinary civil business in Turkey will be withdrawn, unless the risk is taken elsewhere than on ECGD's trading accounts. OD has already

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invited me to consider arrangements to meet, without detriment to civil business, the large credit requirement for arms sales. I shall be coming forward with recommendations shortly.

CONCLUSION

15. I recognise the problem in regard to credit. But the strategic and industrial case is strong. Provided the banks' reactions are favourable, I think we should allow BAe to go ahead.

RECOMMENDATION

16. I invite my colleagues to agree ECGD support for the revised BAe proposal.

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Department of Trade and Industry

30 October 1984

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ANNEX A

	£millions	
	<u>Figures discussed by OD</u>	<u>Revised BAe proposal</u>
Contract value	985	985
Cash payment	148 (15%)	246 (25%)
Credit requirement	837	739
UK Share (58%)	487	429
Total exposure (principal & interest)	860	760
ECGD's share	344 (40%)	228 (30%)
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Banks/ Suppliers	516	532

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## TORNADO EQUIPMENT SUPPLIERS

COMPANY	TOWN
AEROQUIP	REDDITCH
AIRSCREW HOWDEN	WEYBRIDGE
AUTOMATIVE PRODUCTION	WESTHOUGHTON
BAe	HATFIELD, WEYBRIDGE
BESTOBELL	SLOUGH
BRISTOL COMPOSITE MATERIALS	BRISTOL
BRITISH OXYGEN CO	HARLOW
CHELTON	MARLOW
COMPUTING DEVICES CO LTD	ST LEONARDS-ON-SEA
COSSOR ELECTRONIC LTD	HARLOW
DARCHEM AERO LIMITED	STOCKTON-ON-TEES
DAVALL GEAR CO LTD	WELHAM GREEN
DECCA NAVIGATOR CO LTD	NR. HATFIELD
DOWTY ELECTRICS	LONDON
DOWTY ROTOL	CHELTENHAM
DUNLOP LTD	CHELTENHAM
DUNLOP LTD	GATESHEAD
DUNLOP LTD	LOUGHBOROUGH
FAIREY HYD LTD	COVENTRY
FERRANTI LTD	HOUNSLOW
FERRANTI LTD	EDINBURGH
GLOSTER SAR LTD	MANCHESTER
GRAVINER LTD	HUCCLECOTE
HIGH TEMPERATURE ENGINEERING	SLOUGH
HYMATIC ENGINEERING COMPANY	FAREHAM
LUCAS AEROSPACE LIMITED	REDDITCH
	WOLVERHAMPTON

LUCAS AEROSPACE LIMITED  
LUCAS AEROSPACE LIMITED  
LUCAS AEROSPACE LIMITED  
LUCAS AEROSPACE LIMITED  
LUCAS AEROSPACE LIMITED  
LUCAS AEROSPACE LIMITED  
LUCAS AEROSPACE LIMITED  
LUCAS ELECTRICAL ELECTRON  
MARCONI AVIONICS  
MARCONI AVIONICS LTD  
MARCONI CO LTD  
MARCONI INSTRUMENTS LTD  
MARCONI INSTRUMENTS LTD  
MARSTON LUBRICANTS LTD  
MARSTON PALMER LTD  
MARTIN BAKER  
  
NORMALAIR-GARRETT LTD  
PAGE ENGINEERING CO LTD  
PLESSEY CAPACITORS LTD  
PLESSEY CO LTD  
PLESSEY CO LTD  
PLESSEY CO LTD  
PLESSEY CO LTD  
ROSEMOUNT  
SANGAMO WESTON LTD  
SMITHS INDUSTRIES  
SMITHS INDUSTRIES LIMITED  
SMITHS INDUSTRIES LTD  
SMITHS INDUSTRIES LTD  
SMITHS INDUSTRIES LTD  
SPERRY VICKERS  
ULTRA ELECTRONICS LTD

BRADFORD  
BURNLEY  
BIRMINGHAM  
HEMEL HEMPSTEAD  
LUTON  
COVENTRY  
BRADFORD  
BIRMINGHAM  
ROCHESTER  
BASILDON  
STANMORE  
STEVENAGE  
LUTON  
LIVERPOOL  
WOLVERHAMPTON  
HIGHER DENHAM  
NR. UXBRIDGE  
YEOVIL  
SUNBURY-ON-THAMES  
TOWCESTER  
ILFORD  
FAREHAM  
HAVANT  
POOLE  
BOGNOR REGIS  
ENFIELD  
BISHOPS CLEEVE  
LONDON  
BASINGSTOKE  
CHELTENHAM  
RUGBY  
HAVANT  
LONDON

ULTRA ELECTRONICS LTD  
WESTLAND HELICOPTERS LTD  
WESTLAND HELICOPTERS LTD  
WOODVILLE POLYMER ENG LTD

GREENFORD  
YEOVIL  
BLETCHLEY  
BURTON-ON-TRENT

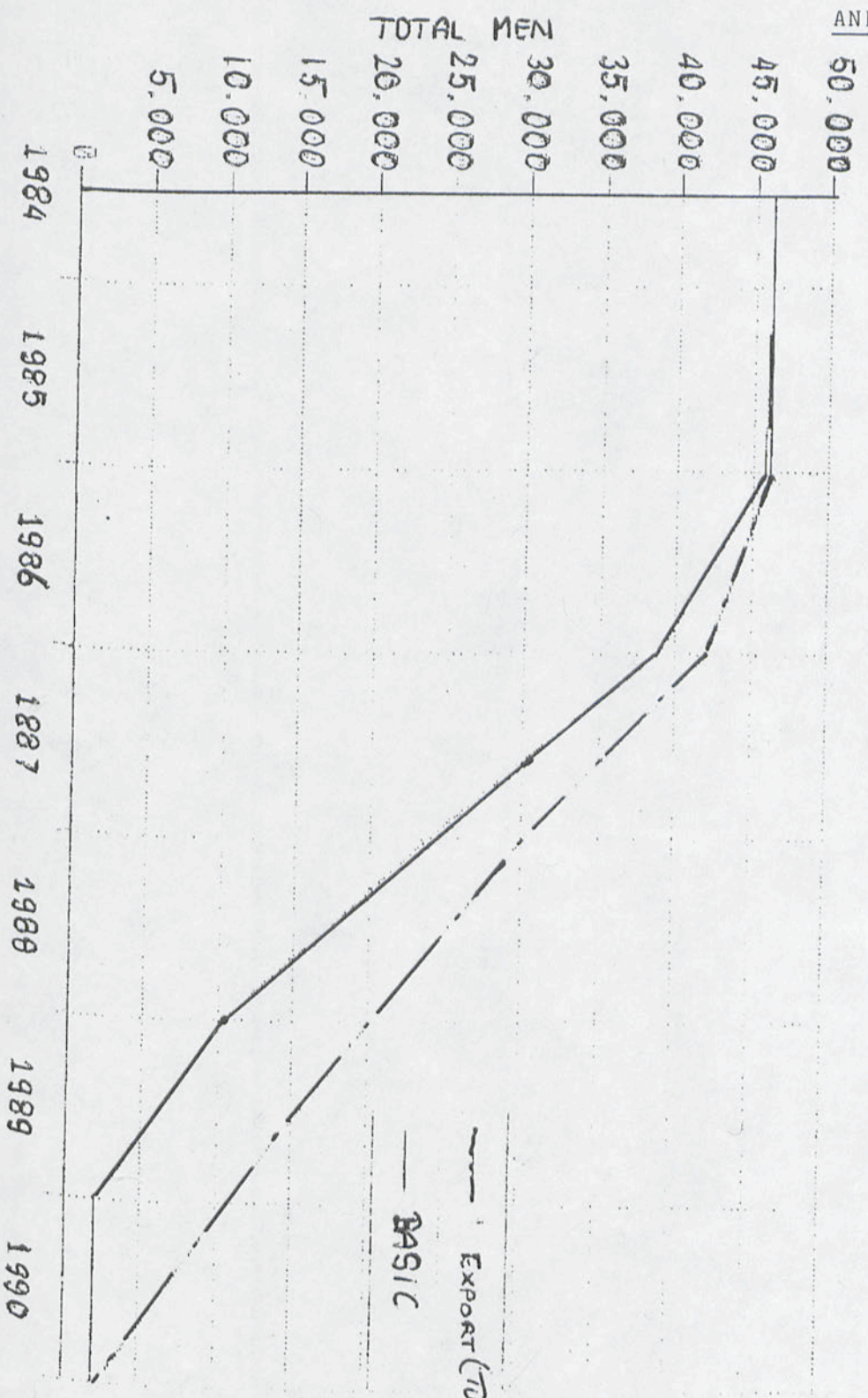
NOTE:

This list covers only the suppliers for the airframe and the avionics equipment and does not include Rolls Royce or other engine equipment suppliers.



# TORNADO - U.K. EMPLOYMENT

ANNEX C



Includes 17,600 Man Yrs  
For A/c + Support  
b) 10,900 Man Yrs  
for Weapons

EXPORT (TURKEY)  
BASIC

FOR RESEARCH ONLY



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PRIME MINISTERTORNADOS FOR TURKEY

I have seen Norman Tebbit's recent minute to you on this subject. Unfortunately, I shall be out of the country when the subject is to be considered in OD, and Adam Butler will represent me at the meeting. I should put on record; however, that my view of the balance of risks and advantages on this matter coincides with that of Norman Tebbit.

2. I also agree with Norman's conclusion that the Government ought to find some special way of providing the credit support being requested, subject to British Aerospace being able to arrange the private sector share of the risk. As I said in my minute to you of 13th August, quite apart from the industrial arguments in favour of Government support, Turkey's position on NATO's flank makes the Tornado deal of particular military significance to the Alliance as a whole.

3. I am sending copies of this minute to other members of OD, to Tom King and Sir Robert Armstrong.

Ministry of Defence  
3rd October 1984



PRIME MINISTER

TORNADOS FOR TURKEY

I minuted you on 10 August on difficulties arising for us in providing export credit support for the prospective sale to the Turkish airforce of 40 Tornados. Nigel Lawson, Quintin Hailsham, Michael Heseltine, Janet Young and Arthur Cockfield have all commented. The problem arises essentially from the large payment risk exposure that would arise which cannot be accepted by ECGD as a normal Section 2 operation, even on the basis of risk sharing with the private sector.

2 When I wrote before, we were looking at a potential UK order of about £435m (which would have meant an exposure taking into account interest etc of about £600m). BAe have since revised their estimates and have told us that, with cost escalation, spares etc, and with the private sector being unable to support more than 60% of the risk, the

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figures would work out significantly higher, as follows:

	£m
Total contract value	985
UK share (58%)	571
UK credit (85%)	485
Total exposure (including interest etc)	860
of which: ECGD exposure (40%)	344
Private sector (60%)	516

The Turkish Defence Minister has told Michael Heseltine that they will award us the contract for this sale now provided we can offer finance, and BAe are under pressure to come up with credit proposals. However, there is no evidence that the Turkish Ministry of Finance has yet approved the deal. The Turks have emphasised that for operational reasons the order cannot be reduced in size. Although ECGD's exposure would be very large, the balancing share to be carried by the commercial banks and BAe and its principal sub-contractors has also increased substantially. BAe

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believe there is a reasonable prospect of this risk sharing arrangement being taken by the private sector, although in ECGD's view this is doubtful and it is almost certain that the later maturities will fall to HMG to support.

3 I realise that the arguments are carefully balanced here. Those in favour of giving the HMG support necessary to secure the order are as follows:

a) The industrial case is strong, as I made clear in my minute of 10 August. I accept Nigel Lawson's point that there is no commitment to the EFA programme at present. This makes export orders for Tornado still more significant industrially. Besides Turkey, I understand that there are also export prospects in Saudi Arabia and Oman (initially 20 and 8 aircraft respectively). Both are going to be difficult and are likely to be strongly influenced if we can secure the Turkish order. Taken together, these three possibilities offer an opportunity for the UK to improve its disappointing record in large defence export contracts (as compared for example with the French). Some measure of the industrial importance of the Turkey sale can be gauged from BAe employment

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projections. There are 4000 direct production staff at Warton. BAe estimate that these will reduce to 2500 by 1990 even if the Saudi and Oman orders are won. The Turkish order alone would enable an additional 500 production staff to be maintained through to 1990;

b) The Tornado programme is also of great significance to the aero engine and equipment industries. Rolls Royce's share of the Turkish order is estimated to amount to £60 million initially, plus a further £60 million in spares business;

c) The main repayments on any credit for Tornados would not commence until around 1987/88;

d) We must recognise that the Turks place great importance on the purchase of these aircraft from us and our partners. A refusal to provide finance may damage relations with a country which, as Janet Young points out, is one of our closest allies. On the other hand, the Greeks can hardly complain, since we offered them the aircraft as well and they rejected it;

e) If the UK does not supply these aircraft the Turks

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will probably buy them elsewhere. The USA or France will be only too ready to displace us, and can be expected to have fewer difficulties in offering finance on favourable terms; and

f) The Turks have scrupulously met their obligations to date on BAe's existing sales of Rapier and Sea Skua missiles (which were mainly for cash).

4 The main arguments against HMG support are:

(a) The risk exposure now proposed of about £350m is far above ECGD's existing market limits for Turkey, which will be facing difficult debt servicing problems from 1985 onwards as previously rescheduled debts fall due for payment again;

(b) Although Turkey's recent record on military debts has been satisfactory, Turkey has rescheduled its civil debts on many occasions, and ECGD is still owed some £120m which will not be repaid finally until 1992;

(c) BAe have already had the benefit of almost all of the new medium term ECGD cover for Turkey allocated so

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far (some £77m for Rapier and Sea Skua missiles); normal commercial exports have increased by 40% in the first seven months of 1984 and are currently running at an annual rate of £330m; if support on the scale proposed is agreed this would pre-empt any capacity to give cover for other project business (which would undoubtedly cause vigorous protests from many UK companies, currently negotiating in Turkey); and

(d) There must be doubts about the ability of the private sector to carry its share of the exposure and so there is a risk that BAe will ask for more HMG support later.

5 As I mentioned in my previous minute, if ECGD were to be instructed to take a commitment of this order, it would be necessary for this to be announced to Parliament and for the commitment to be taken outside ECGD's trading accounts.

6 This is a difficult decision. On the one hand there is concern at Turkey's economic prospects. On the other hand, the case is strong on strategic, political and industrial grounds. On balance I recommend that Government ought to find some special way of providing the support being

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requested, subject to BAe being able to arrange the private sector share of the risk. It would, of course, be necessary for BAe's German and Italian partners to be prepared to take their share of credit risks, but I believe that they would be likely to do so given a lead from the UK.

7 I am copying this to members of OD, to Tom King and to Sir Robert Armstrong.

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September 1984

Department of Trade and Industry

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