

019

CONFIDENTIAL

Prime Minister

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JH 365



PRIME MINISTER

A decision is needed tonight (Thursday)

Para. 5 is the nub.

You may think that at this stage we should offer full capitalisation of interest, which Treasury and ECW could support.

We should then be able to consider adding local costs support later.

GUANGDONG NUCLEAR PROJECT

Yes not Agree?

A.J.C. 25/11

The purpose of this minute is to up-date you and colleagues on the negotiations on this project; and to recommend that we should now make an improved but final credit offer to the Chinese.

2 The French deeply impressed the Chinese with the scale of their nuclear programme. And in support of their strong industrial position the French have offered the equivalent of the UK's credit terms. Their new formal offer is 10% over 15 years with support for local costs up to 15% of the French project content, or equivalent support for capitalisation of pre-commissioning interest and the Chinese have now told my officials that the French have undertaken to consider further the case for full capitalisation of interest and other measures which would reduce the effective interest rates on the loans. I think we must assume that some further French inducement will be forthcoming if the Chinese decide to place the whole project with the French. Building on this, the French have proposed to the Chinese that they should take the lead on the whole project, offering GEC some sub-contract work on the conventional island in



recognition of the British interest in the project through Hong Kong.

3 In effect, the French appear to have rejected our overtures for co-operation on this project - and to have played a strong hand to win the whole project. It would not be acceptable to us or to GEC simply to be sub-contractors for comparatively minor items of plant.

4 In the light of this I have reconsidered our negotiating position. Despite their excellent engineering capabilities and proven export record, GEC cannot match the depth of PWR experience which the French can offer. It is not easy to determine how far our weaker industrial position is counter-balanced by our position in Hong Kong. In the present delicate state of negotiations on the future of the territory, it may not be possible to play this card too hard. In informal discussions with my officials over the last couple of years Lord Kadoorie has indicated that he would be unwilling to refuse outright to purchase power from a nuclear station in which the UK did not have a major industrial role, though he would be less willing to purchase a major share of the electricity output in the early years. In the present climate the Hong Kong Government too may not wish to press British industrial interests too hard. My view is that to secure the conventional island for GEC we shall need to enhance the Hong Kong card with an attractive credit package.



5 I believe, therefore, that at the final meeting I shall have with the Chinese on Friday 26 November I should indicate to Li Peng that we would be willing to offer a final concession on credit on condition that he was prepared to agree that the contract for the conventional island should be awarded to GEC. My officials have discussed with the Treasury and ECGD two possible alternatives. The first is the granting of full capitalisation of interest without strings instead of the concession we have already made on the financing of local costs. The alternative is the full capitalisation of interest in addition to the local costs support. Treasury and ECGD would be prepared to recommend the first but not the second. Whilst the first would undoubtedly be helpful I feel that it would be worthwhile going for the second if we were able to clinch the deal. I attach at Annex A a short schedule which shows the cost and level of subsidy for these two options compared with the offer we have already made. The discount rate used is the current long-term dollar bond rate of 11.6% since the financing is likely to be in dollars.

6 There is clearly a risk that the French will again match our credit package, but I am convinced that we should make this improved offer in a final attempt to secure the conventional island for the UK, and at the same time to give Li Peng a concession, beyond what was offered by my officials in Guangdong

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in July, which he can take back to the State Council.

7 I am copying this minute to Francis Pym, Geoffrey Howe, Nigel Lawson, Arthur Cockfield, Leon Brittan and Sir Robert Armstrong.

PJ

P J

25 November 1982

Department of Industry



GUANGDONG PROJECT

Subsidy Element involved in the provision of Interest SubsidyConventional Island, Escalated Cost £598.44m

	<u>Actual HMG Subsidy</u>	<u>Discounted HMG Subsidy</u>	<u>Subsidy Element</u>
	£m	£m	%
A. Present Offer (85% + local costs)	124.08	45.13	11.02
B. Alternative Offer (85% + Capitalisation)	157.21	53.86	13.15
C. Proposed Offer (85% + local costs + capitalisation)	184.95	63.37	15.47

NOTE: Discount rate used is the current long term dollar bond rate of 11.6%

25 NOV 1981

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Treasury Chambers, Parliament Street, SW1P 3AG
 OF-233 3000

26 November 1982

N.B. P.D.

The Rt. Hon. Patrick Jenkin, MP
 Secretary of State for Industry
 Department of Industry

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Patrick

GUANGDONG NUCLEAR PROJECT

I have seen a copy of your minute of 25 November to the Prime Minister.

Naturally, the proposal to increase our offer of subsidy for this project is unwelcome to me. My concern is not just with the subsidy cost. At a time of widespread concern about the growth of protectionism I think it would be particularly unfortunate for the UK to expose itself yet again internationally to the charge of leading the credit subsidy race.

My assumption up till now has been that the Chinese decision will turn ultimately on the importance they attach to the Hong Kong connection (and the associated foreign currency earnings). I note from your minute that the Hong Kong card may not now be a very strong one for us, but to try and compensate for this by offering cheap credit could be financially ruinous. It would also be futile since the French will be bound to match whatever we do on credit. In my view the right strategy for us now is to sit tight and refuse to be drawn into a competitive counter-bidding race with the French which can do neither of us any good.

At the same time, I recognise that both in terms of potential subsidy cost and the size of our exposure the terms on which you now envisage bidding for the contract pose less of a problem for the Treasury than we might have had to face. If you are really convinced, in the light of your knowledge of the negotiating situation, that an offer to capitalise interest would clinch the deal for GEC, and would not simply be the

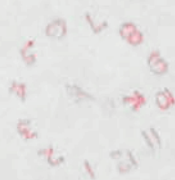
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prelude to another round of bargaining and competitive counter-bidding, I would not wish to press my objections on financial grounds. This is on the understanding that we have now reached our negotiating limit, and that whatever the Chinese response there will be no question of further topping up our offer with aid money, Industry Act assistance or other financial concessions.

I am copying this minute to the Prime Minister and the other recipients of yours.

GEOFFREY HOWE



29 NOV 1982

*Mark Veng,
Guangdong*

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Foreign and Commonwealth Office

London SW1A 2AH

26 November, 1982

Dear John,

Guangdong Nuclear Project

AM 26/11

p.a.

This is to confirm, as I told you on the telephone, that Mr Pym agrees with the line in Mr Jenkin's minute of 25 November. British participation in the project would thicken our bilateral relations with China considerably and also have favourable implications for the future of Hong Kong. But as Mr Jenkin points out, our position in Hong Kong (the 'card' referred to in paragraph 4 of his minute) is not something we can play up very strongly with the Chinese in present circumstances to offset the technical advantage held by the French. Further financial concessions therefore seem appropriate.

I am copying this to the Private Secretaries of the recipients of Mr Jenkin's minute.

Yours ever

(J E Holmes)
Private Secretary

A J Coles Esq
Private Secretary
10 Downing Street

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10-11-1982

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26 NOV 1982

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Bo B
Hong Kong

10 DOWNING STREET

From the Private Secretary

26 November 1982

GUANGDONG NUCLEAR PROJECT

The Prime Minister has seen the minute of 25 November by the Secretary of State for Industry.

Mrs Thatcher agrees that at the final meeting which Mr. Jenkin will be having with Mr. Li Peng today we should offer full capitalisation of interest instead of the concession we have already made on the financing of local costs. She notes that the Treasury and ECGD are content with this proposal.

The Prime Minister does not consider that we should offer local cost support in addition at this stage. But she would be willing to examine this possibility if, at a later stage, Mr. Jenkin thought it necessary to secure the contract for the conventional island.

I am copying this letter to John Holmes (FCO), John Kerr (HM Treasury), Julian West (Department of Energy), John Rhodes (Department of Trade), John Gieve (Chief Secretary's Office, HM Treasury) and Richard Hatfield (Cabinet Office).

A. J. COLES

Ms Caroline Varley,
Department of Industry.

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