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Soviet  
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Ref. A03832

PRIME MINISTER

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Credit Terms for Business with the Soviet Union

(OD(80) 75)

BACKGROUND

Although this Note by the Secretary of State for Trade deals with one potential order for the Soviet Union, the underlying point at issue is the implied reversion to a trade policy towards the Soviet Union not unlike that which obtained before Afghanistan. On 17th January 1980 the Cabinet took note of your statement on the policy which the Ministers concerned had agreed should be pursued following the invasion; this included not renewing the Anglo-Soviet credit agreement. OD discussed the matter on 22nd January and agreed that Britain should refuse to accord the Soviet Union subsidised credit terms more favourable than the OECD consensus - provided that other relevant members of the European Community did the same, which in the event the French are not doing.

2. The Secretary of State for Trade in a letter to the Foreign and Commonwealth Secretary and OD colleagues of 18th September, which he copied to you, proposed a review of the Government's attitude to trade relations with the Soviet Union. He pointed out that if the United Kingdom, in contrast to virtually every other Western Government, continued to maintain its present attitude the amount of business coming to Britain seemed bound to decline. This approach secured the guarded agreement of OD colleagues that some relaxation in current policy was necessary to protect the competitive position of British exports of non-strategic goods to the Soviet Union. The Secretary of State for Trade is now proposing a significant further step in order to improve Rolls-Royce's chances of securing over £200 million worth of orders for gas compressor engines for the gas pipeline from the Soviet Union to Eastern and Western Europe. This would provide at least 400-500 jobs over the period 1982-85.

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3. The gas pipeline will be of direct benefit to a number of our Continental allies, but not to Britain. This may make our position more open to criticism than theirs would be, in relation to any specially favourable terms which are offered to the Russians.

4. The urgency for an OD decision stems from the fact that the Soviet Union have asked Rolls-Royce's bankers (Midland) to submit financing proposals in early January 1981.

5. The Committee will be somewhat reduced in size as the Secretary of State for Defence will be in Canada, the Lord President in Rome, and both the Lord Chancellor and Lord Privy Seal are likely to be detained by Parliamentary business. The Chancellor of the Exchequer may also be late. The Secretary of State for Industry has been invited because of his interest in Rolls-Royce and the Chief Secretary because of the public expenditure implications of the subsidised credit proposals.

#### HANDLING

6. You will wish to ask the Secretary of State for Trade to introduce his paper. The points to establish in subsequent discussion are -

- (a) What are the views of the Foreign and Commonwealth Secretary on this proposed change in our trade relations with the Soviet Union? How would the change be regarded by our allies, particularly the United States? Would the Soviet Union read it as a signal that this country was prepared to forget about Afghanistan and regard the fate of Poland with relative indifference? Or might the importance of this kind of order to the Soviet Union have a restraining effect on their Polish policy? The answers to these questions are by far the most important issues to be considered by the Committee on this occasion. If the Committee forms a clear view against any change in current policy, it will be unnecessary to spend time considering the commercial, industrial and financial balance of advantage in relation to the Secretary of State for Trade's proposal. But if the Committee decide that this proposal would involve this country in doing little more than some of our

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major allies are already either doing or contemplating, you will wish to consider the actual merits of the proposal itself. In that case, you will wish to pursue the following points.

- (b) How important does the Secretary of State for Industry consider this prospective business to be to Rolls-Royce's industrial and marine division? Is any high-level technology involved? (The paper suggests that there is no COCOM problem).
- (c) How do the Chief Secretary and the Secretary of State for Trade regard the financial implications of matching French competition in this and future cases? At some point on the subsidy scale export business ceases to be worth having (e.g. ships for Poland); how near that point would this business be? The Chief Secretary is likely to argue that Britain should not be in too much of a hurry to match the expected French credit offer on the grounds that the Soviet Union may have strong reasons for placing the proposed order with Rolls-Royce in any case. This is because Rolls-Royce already have a record of proven success in this field in the Soviet Union, and the programme is so large that in their own interest the Russians are going to be compelled to spread orders fairly widely. He may also suggest that we should not react too quickly to Soviet tactics designed to achieve cheap credit by playing off one country against another. Finally he may suggest that the proposed size of subsidy (£9.8 million) is too large in relation to the number of jobs which will be created by the Soviet order. But this of course depends on the ultimate size of the order.
- (d) How does the Secretary of State for Trade reconcile his proposal with the conclusion of the European Community meeting on Credit on 10th December at which all the countries present including France thought it was premature for firm commitments to be made on the pipeline project? Is there a risk that, if ECGD are allowed to match, we shall be left isolated because our allies continue to adhere to the consensus and the French return to it when their agreement is reviewed in September 1981?

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- (e) What will be the extent of this country's commitment if the Committee agree to the Secretary of State for Trade's proposals, the Midland Bank submit financing proposals to the Soviet Union and the latter subsequently invade Poland? In the case of Afghanistan existing transactions were allowed to run their course; but they might not be after an invasion of Poland.
- (f) In the Secretary of State for Trade's view how relevant are timing factors in relation to this transaction? How likely are Rolls-Royce to lose the proposed business if the Midland Bank is not ready to submit financing proposals in early January? More time would allow the Soviet intentions towards Poland to become more clear and would also be in keeping with the conclusion of the European Community meeting on Credit on 10th December. But how much more time would be most appropriate in the circumstances? Three months?

#### CONCLUSION

7. In the light of discussion on these points, the Committee will wish to take particular account of the views of the Foreign and Commonwealth Secretary. If he argues that it would be totally out of keeping with our current policy towards the Soviet Union to make this particular relaxation in current trade relations, and that it would be widely misunderstood by our allies, you may feel that the Committee ought to be guided to the appropriate conclusion. But if the views of the Foreign and Commonwealth Secretary are less clear cut (which is probable) and the Secretary of State for Industry makes out a powerful case about the importance of this business to Rolls-Royce and British industry, you may care to guide the Committee to the conclusion that in principle they accept the Secretary of State for Trade's proposal that ECGD should be allowed to match credit offers for the pipeline business (within the limits of their normal commercial judgment) and should be authorised to match other cases subject to the usual procedure. But you may wish to stipulate that they should not move in this direction just yet; and that before they do so, Ministers should consider

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the matter further on the basis of a submission from the Secretary of State for Trade which might be circulated in 2-3 months' time (you will need to set the timescale) and cleared "out of Committee".

RA

(Robert Armstrong)

17th December, 1980

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