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10 DOWNING STREET

*From the Private Secretary*

Mr. Hatfield

Sale of Rolls-Royce Gas Turbines to the Soviet Union

Thank you for your minute of 2 March.

The Prime Minister has read the note on the above matter which was prepared by the Cabinet Office and agreed by Misc 64. Subject to the views of her OD colleagues and the Secretaries of State for Industry and for Energy, Mrs. Thatcher agrees with the recommendations in paragraph 15 of the note.

I am sending copies of this minute to the Private Secretaries of other members of OD and of the Secretaries of State for Industry and for Energy.

A. J. COLES

4 March, 1983.

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cc. Sir A. Parsons

Soviet Union <sup>to</sup>

to

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Prime Minister

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This is much clearer than the previous papers.

2. Subject to views of ministerial colleagues, agree to recommendation in para. 15?

Ref. A083/0698

MR COLES

copy: Sir A. Parsonage

A.J.C. 2/3

Sale of Rolls-Royce Gas Turbines to the Soviet Union

You wrote to Mr Bone on 17 February to ask for a detailed assessment of the likely United States reaction if this sale goes ahead.

2. The Foreign and Commonwealth Office agreed that the task of preparing an assessment could best be entrusted to MISC 64, the Official Group on Economic Policy towards Eastern Europe. The enclosed note has therefore been prepared by the Cabinet Office and agreed by MISC 64. Paragraph 15 sets out specific recommendations for handling the matter.

3. It would be helpful if these recommendations could be endorsed soon, if possible in the course of this week. Although negotiations between Rolls-Royce and the Russians are unlikely to come to fruition for a considerable time, the story may leak and precipitate a damaging row with the Americans. The sooner, therefore, that the proposed consultations with Rolls-Royce take place, the better.

4. I am sending copies of this minute and the enclosure to the Private Secretaries to the other members of OD and to the Private Secretaries to the Secretaries of State for Industry and for Energy.

R P HATFIELD

2 March 1983

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**SALE OF ROLLS ROYCE GAS TURBINES TO THE SOVIET UNION**

Note by Officials

**INTRODUCTION**

1. Rolls Royce Limited hope to sell gas turbine engines, spares and maintenance facilities to replace their existing Avon engines in operation with the Chelyabinsk Pipeline in the Soviet Union. The deal would be part of a larger contract that includes the associated power turbines and compressors, to be supplied by a United States company (Cooper Industries). Rolls Royce have asked Department of Trade officials what attitude the Government is likely to adopt towards their involvement in the deal. The timing of any Soviet decision to award a contract to Rolls Royce is uncertain; while it could come as early as May, past experience of major contract negotiations with the Soviet Union make a substantially later date (eg Autumn 1983) no less likely.

2. This paper assesses the likely reaction of the United States Administration; and summarises the advantages of Rolls Royce going ahead with the sale and the disadvantages of not doing so.

**LIKELY UNITED STATES REACTION**

3. Her Majesty's Embassy Washington (telegram number 401) believe the sale would be seen as a "gratuitous slap in the face"; and see "some risk" that the Administration's critics would use it as further evidence that the Americans had been taken for a ride by the Europeans and got little or nothing in return for lifting pipeline sanctions. Because the sale would be seen as pre-judging the outcome of the post-pipeline studies, United States confidence in the seriousness of the United Kingdom's approach could be undermined. Similarly, the position of our friends in the Administration, whose moderating influence we shall need in the run-up to Williamsburg, might be weakened. The Embassy's tactical advice is therefore against our giving official blessing to Rolls Royce, who should make their own judgement; and in favour of playing the matter long, if possible until after Williamsburg.

4. The accuracy of this judgement depends crucially on the extent to which Administration opinion is coming to accept that the United States will gain little more from the studies than greater transparency in, and better oversight of, East-West trade in other high technology (OHT), perhaps combined with a continuing scrutiny of emerging technologies. Such an outcome, which represents

the highest conceivable common denominator, could be plausibly presented as a positive achievement but would fall well short of an embargo or ban. The question therefore is whether Administration opinion has yet come to accept that such a minimalist outcome is the best they can expect. If it has not, the Embassy view may be right. But if it has, the Americans might accept that they would lose more than they would gain from making an issue of the Rolls Royce deal.

5. Another relevant factor, not mentioned by the Embassy, is that the Americans themselves will face a dilemma if and when they learn of the involvement in the project of a United States company, Cooper Industries (CI). Having scrapped their December 1981 and June 1982 measures, the Americans, like ourselves, have no powers to prevent CI from seeking to sell the products concerned as they do not fall under COCOM controls. Unless, therefore, the Americans decide to reintroduce controls specifically to frustrate a deal between CI and the Russians, they are hardly well placed to criticise the British Government for failing to act. And if they were to reintroduce controls, this would prejudge the outcome of the studies.

#### ADVANTAGES OF GOING AHEAD WITH THE SALE

6. Business worth £10 million initially is at stake. There is potential business to the value of £200 million (£20 million per year over ten years at 1983 prices). This represents a 50 per cent increase in Rolls Royce's total anticipated industrial sales of gas turbines over the period.

7. We do not see a significant risk of technology transfer. The equipment concerned uses technology which is now ten years old. There would be difficulties of "reverse engineering" (eg if the Soviets tried to replicate the turbine blades). Moreover, the initial order, and at least some of the follow-up orders, are replacements for existing (but smaller) Rolls Royce Avon engines. To this extent the contract does not break new ground.

8. During the pipeline dispute last year, we persistently stated that the sale of oil and gas equipment did not pose a security risk. We have also stated that, while we were ready to participate constructively in the follow-up work

on East/West economic relations, we were not prepared to prejudge the outcome. (This includes the discussions of possible new controls on oil and gas equipment). It would thus be wholly inconsistent with our policy throughout the period to seek to frustrate this deal.

DISADVANTAGES OF NOT GOING AHEAD WITH THE SALE

9. Loss of the order would be a serious blow for Rolls Royce at a time when demand for civil aero-engines is low. Other potential business might be prejudiced, not only for Rolls Royce but also for other United Kingdom companies including General Electric (GEC) and John Brown Engineering (JBE). Since the Government supported Rolls Royce in their bid for the West Siberian gas pipeline and supported other British companies in bidding for the Astrakhan gas project, it would be a major reversal of policy to intervene now to frustrate the deal.

10. Such action could also damage our relations with our European Community partners (principally France and FRG) who have similarly opposed United States attempts to extend export controls beyond those required by existing COCOM strategic criteria. Indeed, it would be seen as prejudicial to European industrial interests generally. Japan would react similarly.

11. The Government would have to introduce a new Statutory Order to prevent the export of this equipment. Export licences are not at present required and the equipment is not subject to COCOM embargo. Moreover, it is unlikely that COCOM will agree to a United States proposal in the current COCOM List Review to control the export of aero-derived industrial gas turbines. Ministers are being invited separately to endorse a negotiating line in COCOM that the United Kingdom should oppose controls on the export of such equipment but support controls on the export of the sensitive technology involved. There are informal indications that most other COCOM countries support this line. If, as seems probable, no COCOM controls are agreed, there would be no obligation upon the United States to restrain their companies (or upon other COCOM countries to restrain foreign licensees of United States firms) from offering aero-derived turbines or the heavyweight GE turbines supplied for the West Siberian pipeline, Rolls Royce's only competition in this field. Thus if Rolls Royce were to be restrained from exporting aero-derived engines, the commercial initiative would pass to the United States which would enjoy an effective monopoly.

12. A Government decision to restrain Rolls Royce would be bound to become public. The Financial Times has already carried an article on the prospective business. Such a decision would be seen as a response to United States pressure and would arouse controversy, with Rolls Royce itself feeling unreasonably subject to political and financial pressures.

13. Finally, preventing this sale may serve to encourage the hardliners in Washington to press harder for controls on Western exports of such equipment to the Soviet Union. It could be invoked as evidence that America's allies will fall into line provided sufficient pressure is applied.

#### CONCLUSIONS

14. There are strong arguments for allowing Rolls Royce to go ahead. To turn them down would be inconsistent with our previous attitude; and would prejudice the current discussions on technology transfer. There are limits to the extent to which we can permit our legitimate commercial interests to be dictated by likely reactions from Washington which we (and other European countries and Japan) believe to be ill-founded.

15. However, HM Embassy Washington sees a clear risk of a hostile United States' reaction. To minimise this risk, while retaining consistency, the following course of action is recommended:-

a. Until the outcome of the post-pipeline study on the export of this equipment is known, we should neither give Rolls Royce formal backing nor discourage them from proceeding with the contract. If Rolls Royce discover in the course of negotiation that absence of a formal United Kingdom backing is likely to prejudice their position, Ministers will need to reconsider the matter.

b. We should explain the position orally to Rolls Royce.

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c. If the Americans approach us, we should explain that we have no legal powers to prevent Rolls Royce from bidding for the business and that there are no current United Kingdom controls on the export of such equipment. To introduce export controls would be to prejudge the outcome of discussions in COCOM.

Cabinet Office

28 February 1983

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