

**SUBJECT**  
cc Master.



BF

JG

10 DOWNING STREET

*From the Private Secretary*

22 February 1984

BABCOCK: POHANG STEEL CO.

Lord King came to see the Prime Minister today (on another subject) and at the conclusion of the meeting raised the subject of Babcock's efforts to win a contract as part of the Pohang Steel project. He explained that ECGD had provided Davy with a low interest finance package and that Posco were now expecting Babcock to come up with a similar package for their part of the project.

BF | He left behind the attached note which the Prime Minister has asked me to pass to the Minister for Trade. She will be interested to know what assistance ECGD or DTI are able to offer for this contract. Subsequently, Lord King 'phoned me to emphasise the urgency of this deal.

(ANDREW TURNBULL)

Steve Nicklen, Esq.,  
Department of Trade and Industry.



POHANG STEEL CO. (POSCO)

currently operate a 9 m tonne/annum integrated steel mill at Pohang, South Korea.

POSCO have decided to build a new integrated steel mill at Kwangyang Bay on the south coast of S. Korea. It will be built in few phases up to 10 m.t.p.a. The first phase (2 m t.p.a.) is now in the procurement stage and several major portions are now placed.

B.-Moxey is bidding for the Raw Materials Handling Contract (RMH) (likely value - \$ 50 m) in conjunction with Korean Heavy Machinery Co. (KOHEMA).

We believe we are currently competitive in a very tough bid and have been well received in various visits.

POSCO have received excellent finance packages on all contracts currently placed (see table).

The Davy bid (item 4) was achieved by:-

- a) an excellent competitive price
- b) a superb U.K.-govt.-supported finance package.

ECGD provided the "6% package" to combat their understanding of competitive government-supported packages from Japan, West Germany and Austria. Confusion reigns since, having provided the package to combat Austria's Voest-Alpine on the Blast Furnace, VA did not bid that package.

Suffice to say that Davy presented their facts in such a way as to convince ECGD to act (good for them) and now ECGD feel a little exposed.

ECGD have been berated by all and sundry for "breaking consensus" and having been assured by all other competing countries that no one will break consensus on RMH, ECGD have promised to behave!

This does Babcock no good at all!

- a) POSCO is convinced that if Davy can swing special terms from HMG, so will Babcock.
- b) The POSCO final bid instructions clearly specify "finance offers below 7%".

ECGD have suggested that Babcock accept our consensus rate (10.7%), then inflate our price to subsidise it. This would mean an increase of approximately \$ 7 m - on a price of \$ 50 m. I am sure this would render us totally non-competitive.

- c) The Korean government has accepted the special U.K. finance package as an indication of U.K. support for Korea - to alter our terms will indicate that we now take an opposite view.



I understand a visit from Tebbit or one of his senior ministers is imminent.

I am currently tackling the problems from every angle:-

Lazards	)	
Korean Merchant Bank	)	our advisers
ECGD (Bob Kemp)	)	
PEP (Benjamin, Neville-Rolfe)	)	

and Davy have been most helpful with their information.

I feel the large guns must roll out urgently!!

G. R. Govan



POSCO KWANGYANG BAY PHASE ICONTRACTS PLACED

Item	Contract	Supplier	Country	Value \$ m	Int. rate %	Term years	Morat- orium years
1	Sinter plant	Voest-Alpine	Austria	77	6.75	18	6
2	Strip Mill	Mitsubishi	Japan	170	6.50	16	6
3	Continuous Casting	Demag	W. Germany	77	6.5 -6.95	18	6
4	Blast Furnace	Davy	U.K.	71	6	10	4
5	Steel making	Voest-Alpine	Austria	70	6.75	20	4

Our current offer from ECGD is 10.7% over 12 years with 4 years moratorium.

Note, it is not possible to state that all these bids are officially supported. We know V.A. are.

No one has claimed the others are not.

Mitsubishi have deemed their package "supplier credit" but have reserved the right to modify it to "buyer credit".



BIDDERS ON RMH

Suppliers	Country	Concensus Rate	Indicated rate from local sources
Nippon Conveyors	Japan	8.2%	6.75 - 6.95%
Sumitomo	--"---	--"---	-----"-----
Mitsubishi	--"---	--"---	-----"-----
I.H.I.	--"---	--"---	-----"-----
Dravo	U.S.A.	10.7%	10.7%
P.W.H.	W. Germany	10.7%	6.75 - 6.95%
B.-Moxey	U.K.	10.7%	?

Note Davy kindly gave us the following data:-

Blast furnace - \$ 71 m successful bid  
 \$ 77 m Demag  
 \$ 82 m I.H.I.  
 \$ 87 m G.H.H.

Of Davy package, U.K. portion is \$ 50 m. This is officially financed at 6%.

The difference between 10.7% and 6% over the term is approx. \$ 10.2 m.

Hence, for Davy to "subsidise" the rate in their price, it would have increased their bid to \$ 81 m.



84-02-20 05:48

\*  
43412 BMGLOS G  
KOMBANK K28579

TO: BOB COCK-MOXY  
FROM: KOREA MERCHANT BANKING CORPORATION, SEOUL  
FEB. 20/

COPY TO : MR. PETER GODWIN, LAZARD BROS. AND CO., LTD. LONDON

FOR: MR. GEORGE GOVAN

I HAVE HEARD FROM LAZARD THAT IT IS INCREASINGLY LIKELY THAT ECGD WILL APPLY THE CONSENSUS RATE OF INTEREST IN SUPPORT OF YOUR BID FOR THE MECHANICAL HANDLING EQUIPMENT FOR POSCO. I FULLY UNDERSTAND ECGD'S DIFFICULT POSITION AND I CAN IMAGINE THE PRESSURE WHICH IS ON BOB KEMP FROM ALL QUARTERS. THE PURPOSE OF THIS TELEX IS TO GIVE YOU A BALANCED PICTURE AS I SEE IT FROM THIS END IN THE HOPE THAT YOU CAN USE IT TO PERSUADE ECGD TO REPEAT THE OFFER MADE IN SUPPORT OF THE DAVY CONTRACT.

1. THE UK WOULD NEVER HAVE WON THE BLAST FURNACE CONTRACT WITH AN OFFER INCLUDING THE CONSENSUS RATE OF INTEREST. ECGD'S ACTION ON THIS POINT HAS BEEN FULLY VINDICATED AND KEMP'S DECISION WAS A GOOD AND A BRAVE ONE.
2. NO ONE INCLUDING POSCO HAVE ANY EVIDENCE THAT THE COMPETITION FOR THAT CONTRACT WAS OFFERING ANYTHING OTHER THAN OFFICIALLY SUPPORTED INTEREST RATES I.E. IT IS NOT BELIEVED THAT THE SUPPLIER WAS SUBSIDISING THE RATE. WE HAVE SPOKEN TO A KOREAN SUB-CONTRACTOR TO THE FOREIGN BIDDERS BUT AGAIN THERE IS NO EVIDENCE THAT THE LOWER THAN CONSENSUS RATE OFFERED IN THE OTHER FOREIGN BIDS WERE OTHER THAN OFFICIALLY SUPPORTED TERMS.
3. POSCO AGAIN ARE FULLY CONFIDENT THAT YOUR COMPETITION WILL OFFER AN INTEREST RATE OF LESS THAN 7% P.A. THEY MADE EXACTLY THE SAME STATEMENT TO US AT THIS POINT IN TIME ON THE PREVIOUS BIDDING AND WERE PROVED CORRECT. IT WOULD BE A MISTAKE TO DOUBT THEM NOW.
4. IT IS MY OPINION THAT IF YOU HAVE TO QUOTE THE CONSENSUS RATE YOU WILL FAIL TO WIN THE BID. IF YOU CAN QUOTE THE 6% P.A. RATE YOU WILL WIN THE BID.
5. THE DAVY TERMS WERE SEEN HERE AS A MAJOR EFFORT BY THE UK TO ASSIST KOREA IN CORRECTING THE IMBALANCE OF ANGLO/KOREAN TRADE WHICH CURRENTLY FAVOURS KOREA. THIS IS A HOT ISSUE AT THE HIGHEST LEVELS OF GOVERNMENT IN LONDON. THE KOREANS HAD LITTLE OPTION BUT ACCEPT THE UK BID. IT WILL SEEM STRANGE TO THE KOREAN GOVERNMENT IF FOR THE SAME PROJECT AND FOR A SUBSTANTIAL BUT STILL SMALLER CONTRACT THAT MEANS OF ASSISTANCE IS WITHDRAWN.
6. MAKE NO MISTAKE, THE KOREANS SEE YOUR BID AS PART OF THE SAME PROJECT JUST AS THEY SAW THE CONTINUOUS CASTING, ROLLING MILLS, BLAST FURNACE AND COKE OVENS AS PART OF THE ONE PROJECT. I FIND IT DIFFICULT TO UNDERSTAND ANY CONTRARY VIEW ON SOME THING SO OBVIOUS.
7. THE UK INITIATIVE AND DETERMINATION TO WIN THE LAST ROUND HAS HAD A LOT OF FAVOURABLE COMMENT RIGHT THROUGHOUT GOVERNMENT AND INDUSTRY HERE. IT HAS BEEN SEEN AS A FRIENDLY GESTURE TO KOREA AT A TIME WHEN THEY HAVE RECEIVED POLITICAL KNOCKS, SET BACKS IN TRADE AND FINANCE - INCREASING PROTECTIONISM, UNDER PRESSURE TO CORRECT IMBALANCES OF TRADE, ETC.
8. THE MINISTER OF TRADE'S VISIT IN TWO WEEKS TIME IS IMPORTANT FOR ANGLO/KOREAN TRADE. IT WOULD STRENGTHEN HIS HAND CONSIDERABLY TO BE ABLE TO DEMONSTRATE THAT THE UK IS NOT ONLY COMPLAINING ABOUT THE INEQUITY BUT ASSISTING KOREA TO CORRECT ANGLO/KOREAN IMBALANCE AND ALLOWS HIM TO REQUEST A GREATER EFFORT FROM THE KOREANS TO NARROW THE TRADE DEFICIT. I CAN ASSURE YOU THAT THE BRITISH AMBASSADOR AND STAFF WILL GIVE YOU ALL THE SUPPORT THEY CAN ON THIS POINT. ALL THIS WILL BE WEAKENED IF THE UK NOW REVERTS TO CONSENSUS RATES.
9. BEARING IN MIND THE PRESSURE ON ECGD, AND ONLY AS A LAST RESORT, I WANT TO SUGGEST THAT ECGD SHOULD MAKE A FIRM OFFER OF AN INTEREST RATE OF 6% P.A. UNLESS ALL OTHER COMPETING BIDS ARE SUPPORTED BY CONSENSUS RATES OF INTEREST IN WHICH CASE THE UK OFFER MUST ALSO REVERT TO THE CONSENSUS RATE. POSCO WILL NOT ACCEPT AN OFFER TO MATCH BUT MAY SEE THIS IS A FIRM OFFER WITH A CONDITIONAL WITHDRAWAL.
10. IF A LETTER FROM THE MINISTER OF TRADE COULD BE INCLUDED IN YOUR BID REFERRING TO THE ANGLO/KOREAN TRADE ANGLE AND THIS OPPORTUNITY TO ADJUST IT AND BEARING IN MIND THE AWARD OF THE CONTRACT MAY BE MADE WHILST HE IS IN KOREA, NO ONE COULD BE ACCUSED OF NOT TRYING.

REGARDS,  
JIM TODD++

CHAIRMAN KOREAN MERCHANT BANK

by loan  
from  
LAZARD'S





Export  
Credits  
Guarantee  
Department

Aldermanbury House  
Aldermanbury  
London  
EC2P 2EL

Telex: 883601

Telephone: 01-~~6011~~  
382-7011

R. T. Kemp  
Under Secretary

Mr George R Govan  
Chairman & Managing Director  
Babcock-Moxey Ltd  
Babcock House  
Bristol Road  
Gloucester GL1 5RT

20 February 1984

*Dear Mr Govan,*

SOUTH KOREA: POSCO PROJECT

This is to confirm the ECGD position, which I explained to you when we met last Thursday.

There is at present in force an international agreement, to which we have subscribed with the approval of British Ministers, to the effect that no derogations will be made from the export credit Consensus guidelines. The minimum interest rate at present prescribed by the guidelines for sterling credits of 10 years is 10.7%. The only way that a lower rate could be quoted, without breach of international undertakings, would be by the use of aid funds. If another country used aid to produce a sub-Consensus interest rate for a particular bid, this might produce grounds for us to match.

In terms of the international rules, there is no reason why Britain should not take the initiative in the use of aid to cheapen the interest rate. However, our own policy is normally not to do this and certainly I do not believe this is likely to be agreed for South Korea. However, as you know, responsibility for administering our own Aid Trade Provision does not rest with ECGD but with Projects and Export Policy Division of the Department of Trade & Industry.

As I explained, it seems to us possible that some of your competitors may raise finance at the appropriate Consensus rate but quote a lower apparent rate of interest in their offer to the buyer; if you would find it helpful to consider using the same cosmetic device yourself, we should in the special circumstances of this case be willing to consider this.

I am copying to Miss M Neville-Rolfe of Projects & Export Policy Division.

*Yours sincerely,*

R T Kemp





NBPM  
AS 17/19

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

Telephone (Direct dialling) 01-215  
GTN 215 .....  
(Switchboard) 215 7877

From the Minister for Trade

17 September 1984

The Rt Hon Peter Rees QC MP  
Chief Secretary  
HM Treasury  
Parliament Street  
LONDON  
SW1P 3AQ

External:  
Prime Minister  
EX Members  
Mr Raison  
Sir Robert Armstrong

ATP: KOREA: POSCO STEELWORKS

I am most grateful to you and Timothy Raison for being so understanding on the extremely awkward POSCO case for Davy and Air Products, which we spoke about last Thursday.

We entirely agree this is a most exceptional case. But for the special circumstances we discussed, I would not have put it forward at all. Given these, however, I felt it right we should look at it collectively. Even under the new arrangements for handling ATP cases worked out by officials I would still expect to put any case as difficult as this to colleagues - though I hope such cases will be very rare.

I accept that we should not regard agreement to this exceptional case as making Korea a regular candidate for initiation. I also warmly welcome your suggestion that we should take advantage of this international shambles to try to stimulate some rather more effective examination in the OECD on introducing real disciplines into the project financing business. Our officials will be in touch to discuss how best we might go about this.

You also said you hoped it would be some while before you saw another 'special case'. If we can now settle on the arrangements agreed at official level, I can assure you yours is a hope I heartily share!

I am sending copies of this to the Prime Minister and members of EX and to Timothy Raison and Sir Robert Armstrong.

PAUL CHANNON

JH4AJP



S. Korea: Relations

Oct 79



'81





a m  
N B P M #5 17/19

Treasury Chambers, Parliament Street, SW1P 3AG

Rt Hon Paul Channon MP  
Minister for Trade  
Department of Trade and Industry  
1 Victoria Street  
London  
SW1H 0ET

14 September

Dear Minister

**ATP:KOREA: POSCO STEELWORKS**

You wrote to me on 12 September about this case and this is to confirm our subsequent telephone conversation.

2 We both agreed that the case falls a long way short of the normal criteria for mixed credits. However I am prepared, very reluctantly, to accept your view that we would be seen in a poor light if we were the only country of the five competing for contracts on Stage II of this projects who were not repeating the offer of concessional finance on Stage I and I agree that ATP may be offered on the blast furnace contract for which Davy McKee are bidding.

3 My agreement is conditional upon your accepting that Korea will not be added to our list of regular recipients of mixed credits and that you will consider how best we can use this case in OECD to demonstrate just how badly some of our competitors are behaving on mixed credits.

4 In the Air Products case I agree that an offer with a grant element of 20.1 per cent should be made as soon as you have firm enough evidence of a French offer for Stage II to enable us to notify it as matching.

5 For the future, if we are to have an agreement between us on arrangements to streamline the administration of ATP - as I hope we can - it really must be understood that cases outside the agreed framework will be very exceptional indeed and that therefore I shall not be faced with another one for a good long time. The Davy initiation will of course count against the limit we agree under the new arrangements.



6 Copies of this letter go to the Prime Minister, members  
of EX and to Sir Robert Armstrong.

Yours sincerely

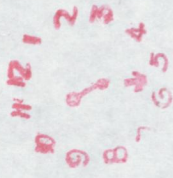
J. Grev  
J. PETER REES

[Approved by the Chief Secretary]



S. K. K. : News

17 SEP 1984







NBPM  
AT  
13/5

OVERSEAS DEVELOPMENT ADMINISTRATION  
ELAND HOUSE  
STAG PLACE LONDON SW1E 5DH

Telephone 01-213 5409

*From the Minister*

13 September 1984

The Rt Hon Paul Channon MP  
Department of Trade & Industry  
1 Victoria Street  
LONDON SW1

*Dear Paul*

**ATP: KOREA: POSCO STEELWORKS**

I have taken an urgent look at this case, as required in your letter of 12 September to Peter Rees; I have some reservations about it.

Like you, I do not welcome ATP in Korea. Although it does not infringe the ATP guidelines it nevertheless runs contrary to the broad orientation of our ATP operations. The DAC Guidelines also require us to strictly restrain the use of aid in mixed credits to stronger developing countries like Korea. Fortunately our record on this is quite good and I would not wish to oppose this particular case on these grounds.

Our chief difficulty, however, is with the developmental case. We have assessed this as far as we can, but the available evidence is insufficient for me to come to a firm conclusion. In the absence of fuller detail about the project itself and the prospects for marketing its output we cannot progress beyond a presumption that, in principle, investment in steelmaking is likely to benefit the Korean economy in the longer term. I should however point out that on the basis of the information we do have this project will add further to Korea's surplus of steel production over domestic requirements and no doubt they will be seeking to export larger amounts.

If a decision on this case is really required now and Peter Rees agrees I am prepared reluctantly to agree to an offer of ATP of up to £7.638 million being made in support of the Davy McKee contract subject to a favourable appraisal of the project. The offer would need to be conveyed to the Koreans in these terms, together with a request for the information needed to do the appraisal. As regards the Air Products Ltd contract I would also agree to a conditional matching ATP offer of up to £3.819 million on the same basis.

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

*Timothy Raison*

TIMOTHY RAISON





1109 SEP 1984  
12  
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10





Note  
CST agreed that  
this offer could be  
made. No EX  
required

10 DOWNING STREET

AT  
12/9

From the Private Secretary

Prime Minister ①

DTI and Treasury are in disagreement  
over an ATP case. If the Chief Secretary  
does not agree, Mr Tebbit may try  
to convene EX after Cabinet as it is  
claimed that the contract will be lost  
if a decision is not made tomorrow.

You need to ask

- (i) is the case really this urgent?
- (ii) should we infringe the rules of the  
game to get this business?
- (iii) if an ATP budget is limited  
should it be spent elsewhere  
where we do not have to "initiate"?

AT

If this is certain business 12/9  
and unlike many other cases I look at  
it is) then I agree that ATP should be  
given.  
ms.



COMMERCIAL-IN-CONFIDENCE

cc NO

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

Telephone (Direct dialling) 01-215 5144  
GTN 215  
(Switchboard) 215 7877

From the Minister for Trade

The Rt Hon Peter Rees QC MP  
Chief Secretary  
HM Treasury  
Parliament Street  
LONDON  
SW1P 3AQ

12 September 1984

*John Peter*

ATP: KOREA: POSCO STEELWORKS

1 I am writing about a difficult and now very urgent ATP case. Officials discussed in SCAT yesterday and were unable to agree. I understand the Treasury in particular has difficulties. Issues of principle are involved and I think it right to put the case to you and to colleagues.

2 The SCAT paper, attached, sets out the arguments. The essential question is simple: should we make exceptional use of ATP to get Davy a repeat contract (which is theirs if they produce the repeat financial terms required) for a blast furnace for the POSCO steelworks in Korea?

3 If we decide against:

- (i) The Japanese, the main competition on Stage I, are bound to offer prices and terms to take the business.
- (ii) We shall thus lose otherwise assured business worth £32 million in UK content - mainly among hard-pressed engineering firms in areas of high unemployment.
- (iii) The advantages to Davy of gaining the Stage I reference in the latest blast furnace technology will be largely negated.
- (iv) Our competitors will see their disregard for international disciplines rewarded.
- (v) Davy will make a considerable fuss, and publicly.





COMMERCIAL-IN-CONFIDENCE

4 If we decide to support Davy and offer ATP we may come under fire for having "initiated" in a market which, although it is aidworthy and now appears on the list of regular recipients of mixed credit, is nevertheless among those where we have indicated to the DAC that we will restrain the use of concessional financing.

5 The industrial and commercial case for support is strong, but I do not welcome ATP in Korea. However, on Stage I all the successful bidders - including Davy - were able one way or another to offer the required terms of below 7% interest. The French quite blatantly broke the rules, and the Austrians softened their finance as well. We can rebut criticism by pointing to the practices of others. Whether we like it or not, the Koreans will get favourable financing one way or another. The Koreans will build this steelworks whether we support Davy or not. The question is simply whether we get the business or our competitors. Is it therefore sensible for us to put British business at a disadvantage where others have broken the rules by being hypersensitive about the use of such means as we have available to achieve what our competitors do in different ways?

6 Davy and their subcontractors must keep in the forefront of high technology process plant, which will remain in demand for a long time to come. But the work will only go to those who stay at the leading edge. If their POSCO I reference is made to appear as a 'flash in the pan' - as it will if POSCO II goes to the Japanese - Davy's chances of getting forthcoming blast furnace work in Taiwan, the US and Europe, must be greatly diminished.

7 The Davy presence in Korea must also be regarded as a bridgehead in an important market, where major project business is beginning to fall off to be replaced by opportunities for UK exporters across a much broader product spectrum. If we are seen refusing support to Davy, our efforts to get many more UK exporters into the market on commercial terms will be undermined.

8 On balance, therefore, despite the difficult features of the case, I feel we should support Davy. The alternative to initiating (in practice, simply matching the activities of our competitors) is a ludicrous situation, in which the contract goes out to international tender; we can then make a "matching" finance offer; but competitors will be able to undercut Davy's declared price. Davy cannot afford to enter 'Kamikaze' bids since they are taking a loss on the Stage I contract as it is.

9 On the Air Products case for the Stage II oxygen plant, the principles are much the same, though the technical issues slightly different. I believe that case is equally worthy of support.





COMMERCIAL-IN-CONFIDENCE

10 The Davy case however is now most pressing. Davy McKee's Chief Executive is at this moment in final negotiations with POSCO. If he cannot give an indication by the end of this week that equivalent financing terms will be offered, he believes the Koreans will start to look elsewhere.

11 Obviously any offer would have to be subject to developmental appraisal, but I should like to be able to confirm an ATP offer, in principle.

12 I should be grateful therefore if you and Timothy Raison could look at this case very urgently, and let me have your views tomorrow morning if possible. Davy need to know what to say by late tomorrow evening our time. If you feel unable to agree the proposal to get this business for Davy (and Air Products as well) perhaps we could discuss the case urgently in EX.

13 I am sending copies of this to Timothy Raison, and, in view of the shortage of time, to the Prime Minister and EX members and to Sir Robert Armstrong.

A handwritten signature in dark ink, appearing to be 'Paul', written in a cursive style.

PAUL CHANNON

A second handwritten signature in dark ink, appearing to be 'Paul', written in a cursive style.





AID AND TRADE PROVISION (ATP) - Case for Aid Finance

SUMMARY

KOREA: DAVY MCKEE and AIR PRODUCTS LTD: STEEL PLANT

Country

Korea

UK Companies

- (i) Davy McKee (Stockton) Ltd
- (ii) Air Products Ltd.

Overseas Customer

Pohang Iron and Steel Company (POSCO) - owned by the Government of Korea.

Project Description and Location

Blast furnace (Davy McKee) and air separation units (Air Products) forming part of a second integrated steel works to be built alongside the first at Kwangyang bay on the southern coast of Korea.

Contract Values

(i) Davy McKee

Total contract value £38 million, with UK content £32million (£26m goods, £6m services), locals £1million, EC £3 million and third country £2 million. Majority of UK goods and services will be provided from assisted areas and in particular the North East via a number of sub-contractors.

(ii) Air Products

Total contract value £19 million, U.K. content £15 million (engineering and equipment £14.5 million, site supervision £0.5 million), EC £2 million locals £2 million. Majority of goods and services provided from North Wales, West Midlands and Scotland.





#### Why Is Aid Needed

To match the activities of competitors, and, particularly in the Davy case, to secure business that will not be available without HMG support and otherwise lost to competitors.

#### How Much Aid

(i) For Davy	£7.637 million
(ii) For Air Products	£3.819 "
Total	£11.457 "

#### Spread of Aid Expenditure

We expect aid to be drawn down more or less equally over three years, commencing in 1985/86.

#### Timetable

This case has been held up pending clarification of the intentions of competitors. Davy McKee have now been informed that FOSCO has requested firm financing offers by 10th September. Whilst we recognise that it will not be possible to give a firm answer by then we wish to pursue this case with all possible speed. It is for this reason that the Minister for Trade has requested that the case be referred direct to Ministers in the event of no agreement at official level.





## KOREA: OPPORTUNITY TO SECURE STEEL PLANT ORDERS REQUIRING SPECIAL OFFICIAL ASSISTANCE

### THE OPPORTUNITY

1 Davy McKee have been informed by the Korean steel company Posco that they will be awarded a contract for the supply of a blast furnace without competitive bidding (worth £38 million - UK content £32 million) provided that they are prepared to repeat the price and financial terms offered on a blast furnace contract that they were awarded earlier this year. These terms (6% interest - consensus then 10.7%) were made possible by controversial use of ECGD's rapid matching facility (ECGD matched an Austrian bid). At least two other countries whose companies were awarded contracts for other parts of this steel works have indicated that they are prepared to offer repeat terms. For Davy to make a repeat offer would again require the support of HMG: this has been requested by Davy's Chairman. In the case of Air Products, where the French applied a last minute mixed credit to oust Air Products, there might be a possibility of reversing the process on Stage II. Although this could be given legitimately in both cases it raises difficulties by virtue of the disparate techniques of countries involved in the total project.

### SPECIAL CIRCUMSTANCES

#### (a) STAGE I BIDDING

2 Davy's first contract was one of eight (full list at Annex A) awarded by Posco for different packages of Stage I of their integrated steel plant development. All met Posco's indication that finance offers should be at below 7% interest rates. The Koreans obtained soft credit because some bidding countries concerned either bent or broke the normal procedures for controlling the terms of officially supported credit. The only countries which did not bend the rules were Japan and West Germany whose exporters conceded a cosmetically low interest rate; they made up the difference on the interest rate in their contact price - or so it is alleged. So far as we can judge, it was the Austrians who first broke ranks in offering soft credit for part of the first steel plant. We followed the pattern they had set, with our rapid matching facility for the blast furnace (thus beating the Japanese), and the French went a step further by offering a mixed credit for the air separation plants without proper notification,





thus denying us the opportunity of matching on this piece of business.

(b) STAGE II OFFER FROM POSCO AND COMPETITORS' RESPONSES

3 Having secured such exceptionally good terms for Stage I contracts, Posco has obtained Korean Government consent to advance the implementation of Stage II (a virtual duplication of Stage I) by some 6 to 9 months, if the terms are repeated, and has informed all of the companies awarded contracts for Stage I that they will be offered second contracts if they are prepared to offer the same prices and finance terms. Davy have been informed by the President of Posco that all the companies concerned, with the exception of Davy, have indicated that they are prepared to offer such terms. At the present time only the Austrians and Germans have confirmed officially that they are prepared to support repeat terms. The French and Japanese export credit agencies maintain that they have not been approached for the business. The French having played a sharp mixed-credit card at the last minute are not likely to miss the second opportunity, and nor are the Japanese. If Davy offer identical and equivalent financing terms for Stage II they are assured of business worth £32 million in UK content. If they do not, a contract for the second blast furnace would almost certainly be awarded to the Japanese.

4 With similar support from HMG, Air Products could also have the opportunity to get back into the running for Stage II business, despite the fact that they were unsuccessful bidders for Stage I. Their bid for the Stage I air separation plant was the lowest on price and offered preferred technology. They were knocked out by the French who made an offer of a mixed credit (up to then all bidders had stood firmly by the normal consensus terms on this contract) without proper advance notification at a stage when it was too late for ECGD to match - the French blatantly bent the notification rules to wrest this business. Air Products, who are an established supplier to Posco, had been informed that Posco is having some difficulty in adapting to the French technology. They believe that with competitive finance terms, there is at least a chance of supplanting the French on Stage II and winning an order for Britain worth £19 million (the Stage II plants would be bigger than those for Stage I). Babcock Moxey were beaten on price for the Stage I raw materials handling plant and are unlikely to have an opportunity to bid for Stage II supply.

EFFORTS TO SEEK AGREEMENT NOT TO OFFER CONCESSIONAL FINANCING

5 The German export credit agency Hermes indicated some weeks





ago that it was prepared to explore an agreement with the countries concerned not to repeat Stage I finance terms. We would, of course, be in favour of a water-tight agreement not to make concessional finance available for Stage II, but such an agreement has not materialised, and indeed, the Austrians have already formally offered to repeat Stage I terms. To put Davy on an equal footing with the Japanese in a no aid situation it would be necessary to get the Japanese to agree not to use apparently legitimate techniques to make their interest rates appear even more favourable than they are already - see para 14. There is no evidence to suggest that such an approach would be successful. On the other hand, if we refuse to make special support available to UK contenders for Stage II there is no prospect of further business for the UK from this project and our competitors will find that their disregard for international disciplines is rewarded. As both Davy and Air Products were the lowest bidders for Stage I contracts this would be a clear distortion of the market.

#### MEANS OF SUPPORT

6 Support could be made available by either offering ATP to the Korean Government (Korea is an aid worthy country by OECD definition) or exceptional provision of ECGD subsidised credits at below consensus rates. The provision of subsidised credits by means of the Rapid Matching Facility would not be possible, on the blast furnace at any rate, as there is no direct matching situation. It would be simpler to apply soft terms by an aid/trade mixture of finance with a grant element of at least 20% as offered by the Austrians and the French. It is envisaged that this <sup>and</sup> intention would be notified internationally in the normal way, <sub>and</sub> everyone will be placed on an equal footing as far as credit is concerned. The Koreans will then be able to place repeat orders in the knowledge that effectively similar terms would be available from all sources, thus enabling them to buy those products which best met their price and technical needs. This approach would give Davy the prime position to pick up the second blast furnace, but it would also put Air Products in with a chance of the air separation units.

#### LEVEL OF ATP

7 The grant element of the 6% finance terms made available under the Rapid Matching Facility to enable Davy to match the perceived Austrian interest rate on Stage I was below 20%. To enable Davy to offer financing terms to meet Korean requirements and the Consensus minimum grant element of 20.1% would require ATP of £7.638 million (Grant Element 20.1% - overall HMG subsidy element 27.4% based on repeat ECGD terms (but at the current Consensus rate) and a 3 year draw down). To enable Air Products to match the concessionality of the French offer for Stage I - grant element 20.1% - would require an ATP grant of £3.819 million (Grant Element 20.1% - overall HMG subsidy 29.26% - based on a 3 year draw down).

999-80





8 The above figures are consistent with our OECD obligations and within our own subsidy thresholds.

ECGD

9 ECGD have indicated, without commitment, to both Davy and Air Products that in principle they are prepared to support a loan on this business on current consensus terms.

#### OBJECTIONS TO OFFICIAL SUPPORT

10 There is an argument that support would be going to help the Koreans to enhance steel capacity, with the latest technology, when there is a world surplus: but the steel produced will be primarily for internal consumption, though for products designed for export markets, eg ships and engineering goods. On the other hand, in the absence of any effective multi-lateral agreement, restraint on our part is simply to the disadvantage of our plant industry, and the Koreans will develop their own industry anyway with orders and technology going to our competitors.

11 Whilst Korea is aid-worthy by OECD definition it is on the borderline and is a rapidly developing country. We have indicated to the DAC that we will restrain the use of concessional financing in such countries. Before Posco, Korea was traditionally a market where strict mixed credits had not been significantly used, though a substantial recipient of Japanese OECF financing, and credit-related support.

#### CASE FOR OFFERING SUPPORT

12 There is no doubt from the experience of Stage I that the Koreans will only accept offers for Stage II with interest rates of 7% or less. Davy would have to offer a repeat 6%. On Stage I both Davy and Air Products were both technically well regarded and quoted the lowest prices for their respective packages. With timely officially supported finance Davy won; without it Air Products lost.

13 If Davy are able to repeat their Stage I financing offer they will be awarded the contract. If not, the Koreans would either offer the business to the Japanese on a negotiated basis or rebid the contract. In either case the Japanese would almost certainly win the business. They would be able, with official Japanese support, to offer the same finance terms as for other parts of Stage I (6.75%-6.95% interest) and can be expected to quote a price that, with the knowledge that they now have of Davy's Stage I quote, would undercut Davy even at a loss. This expectation is strong, as the Japanese won much less business than they anticipated on Stage I because of the unexpected strength of the competition in a market where they have an entrenched position and hitherto





unrivalled experience in supplying steel plants. They would make every effort to regain their supremacy.

14 This raises two general points: firstly, the Japanese are readily able to quote in low interest rate Yen, which, together with the facilities of their trading house system, gives them an intrinsic advantage. This was enhanced in this case by the insistence of the client that interest rates should be below 7% and that only one-third of bids could be made in a low interest currency such as Yen except when this was the native currency of the bidder when up to 50% of the bid was allowed in, eg, Yen. By absorbing the exchange rate risk in their trading house system the Japanese provided half their finance in Dollars at the same low rate. In circumstances such as these UK companies cannot hope to compete on the basis of cosmetic interest rates. Secondly, we know from experience elsewhere in the world that the Japanese will resort to what may be termed kamikaze pricing tactics to ensure that they secure a high proportion of the limited project business that is available. Unless we enable UK companies to at least compete on finance terms, especially in circumstances where a contract is virtually guaranteed, they will not win business away from the Japanese and gain the consequent benefit of remaining in the technological forefront. This will enable the Japanese to continue to forge ahead at the expense of UK capacity and capability.

15 Some of our main competitors either bent or broke the consensus rules in bidding for Stage I, the French most blatantly, and thereby stealing business that would otherwise on price and technology grounds have been awarded to a UK company. Unless we are prepared to demonstrate that we will retaliate in such circumstances, we place UK companies at a serious disadvantage and encourage our competitors to use soft finance when they are behind on price.

16 Other specific points in favour of providing official support are:

(i) The business gained will provide much needed work for hard pressed UK engineering companies. In Davy's case the two blast furnace contracts would create around 1,000 man years of work for themselves and numerous UK sub-contractors, many in the assisted areas, including the North East and especially Cleveland county (where Davy are based) which had the highest unemployment rate of any mainland county in the last three years. Air Products' contract would provide around 400 man years of work, mainly in North Wales, West Midlands and Scotland.





(ii) Both Davy and Air Products quoted the lowest prices for their respective packages. We are not seeking to subsidise uncompetitive firms but merely to enable them to compete on equal terms.

(iii) The Posco specification for the blast furnaces requires a number of advanced technical features and innovations. The development of the required technology to supply these by Davy will place them in the forefront of blast furnace design and engineering. By securing contracts for both furnaces Davy will be able to obtain two valuable references (a second reference is an impressive confirmation of a company's ability) and deny any similar advantage to the Japanese. Davy would be able to claim that they had engineered and built the two latest blast furnaces installed in the world.

(iv) BSC have already fully supported Davy in their efforts to secure the first blast furnace and can be expected to do likewise on the second. They will also be closely involved in technical collaboration to develop the required technology (including advanced computer models for furnace control and energy saving techniques) which they will be able to use in their own operations. BSC will also benefit financially by training Posco personnel and providing supervisors for plant commissioning and start up.

(v) By putting themselves in the forefront of blast furnace technology and denying the Japanese a recent reference, Davy place themselves in an excellent position to take advantage of major export opportunities in other parts of the world mostly on commercial terms, ie:

- |        |   |
|--------|---|
| USA    | - major programme of renovation and refurbishment likely to extend from 1985-1990 |
| Sweden | - furnace enhancement and technical modernisation                                 |
| Spain  | - blast furnace renovation  |
| Taiwan | - new blast furnace at existing works - order to be placed in 1985.               |

(vi) By wresting this business from the French, Air Products would consolidate their position as a major supplier to the Korean steel industry and acquire valuable reference.

(vii) The winning of two, and possibly more, Korean steel contracts involving the latest technology will generally enhance the reputation of UK industry and improve the prospects





for other UK companies seeking to win business in this important and rapidly growing market.

#### CONCLUSION AND RECOMMENDATION

17 There is clear evidence that Posco intend to proceed with the building of Stage II of its integrated steel works at Kwangyang Bay, having called for final proposals by 12 September, and that they will only offer business to companies that are prepared to make the same offers of finance as were made for Stage I. The Austrians and Germans have already officially notified that they are prepared to support repeat terms and there is no doubt that the Japanese and French will follow suit. There are a number of objections to enabling British companies to compete with these terms by means of ATP, essentially because this would technically amount to an initiation in Korea, which has not traditionally been a recipient of substantial declared mixed credits. These can be countered:

(a) This situation reflects the problems that arise from the present inadequate discipline on the financial practices adopted by different countries;

(b) Whilst the UK deplores this as much as anyone, it is not going to deny competitive companies the support that their competitors are receiving from their Governments;

(c) Any provision of ATP would be notified in advance, if practicable citing the unusual features of this case.

18 On this basis, whilst a complex and difficult case, it is accordingly recommended that support in the form of a readiness to offer ATP up to £11.457 million in support of Davy McKee and Air Products to win contracts for Stage II of the POSCO steel development at Kwangyang Bay.

PEP2B





## POSCO STAGE 1 - CONTRACTS AWARDED

Contract	Contractor	Terms
Hot Strip Mill	Mitsubishi (Japan)	6.95% - Yen/\$ - 10 yrs
Continuous Casting	Demag (Germany)	6.5% - 6.9% (DM, Yen, \$, ¥) 9 - 12 yrs
Steel Making	Voest Alpine (Austria)	6.75% - \$ - 12 yrs
Sinter Plant	Voest Alpine (Austria)	6% - 6.75% - \$ - 12 yrs
Materials Handling	IMI (Japan)	6.95% - Yen/\$ - 10 yrs
Air Separation	Air Liquide (France)	2% - FF - 19 yrs 6.95% - DM - 10 yrs 6.95% - \$ - 10 yrs
Blast Furnace )	Davy McKee (UK)	6% - £ - 10 yrs
COKE Ovens	Otto (Germany)	6.95% - DM/Yen - 10 yrs





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Secretary of State for Trade and Industry

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13 March 1984

Andrew Turnbull Esq  
Private Secretary to the  
Prime Minister  
10 Downing Street  
LONDON  
SW1

*Dear Andrew,*

BABCOCK : POHANG STEEL COMPANY

Following my letter of 27 February, we spoke about the possible alternatives for supporting Babcock Moxey's bid to win a contract for the raw materials handling plant for the Pohang Steel Project in Korea.

2 While we were exploring these further, the company informed us that the contract had been awarded to one of their competitors, IHI of Japan, apparently purely on the basis of price competitiveness. IHI quoted a price of US\$48.9m; Babcock's bid did not include the additional cost of bringing the interest rate down below 7 per cent, which was the reason for Lord King's approach to the Prime Minister. It is interesting to note, however, that in addition to an extremely low price, the Japanese company offered an interest rate of 6.95 per cent. We are seeking confirmation from the Japanese authorities that this rate was not officially supported by them, as they had already assured us before the bids were opened. If this is confirmed, the cost of subsidising the interest rate must have been carried by the Japanese company in some way, despite their extremely low price.

*US\$42m compared with Babcock's bid of*

3 The winning price quote by IHI is not untypical of the intensity of price competition we face from Japan for project business throughout the world. In the most recent Project Report (my letter of 24 February to John Coles), I referred to other projects recently lost to Japanese price competition. We are seeking to establish with Babcock how it was that IHI were able to produce such a low price in this case. Babcock

/are ..





are confident that their price was, by any reasonable standards, internationally competitive; they were not the high bidder. We know, for example, that the price quoted by their US competitor, Dravo, was US\$62m. We have seen the same pattern in other cases. The suspicion must be that the Japanese companies are deliberately using kamikaze pricing tactics, backed by the strength of their corporate structure, to ensure that a high proportion of the limited amount of project business that is available in the current recession goes to them.

4 We do not think it necessary for the Prime Minister to write to Lord King, unless she particularly wishes to do so. Officials here have maintained close contact with Babcock senior management since the announcement of the award of the contract to IHI. Babcock's accept that the loss of this contract was quite outside the influence of anything that we could have done.

*Yours ever,  
Ruth*

RUTH THOMPSON  
Private Secretary



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Note DTI informed me that Babcock lost this contract a price AT 913

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From the Minister for Trade

CONFIDENTIAL

Andrew Turnbull Esq  
Private Secretary to the Prime Minister  
10 Downing Street  
London  
SW1

27 February 1984

Dear Andrew,

BABCOCK: POHANG STEEL CO

Thank you for your letter of 22 February.

Both DTI and ECGD have been in close contact with the Company on alternative ways of assisting them to win this important contract, which would provide them with much needed work and place them in a strong position to obtain further business from the later expansion of the steelworks that is planned by POSCO.

The difficulty is that the Koreans have stated explicitly in the bid documents that they expect Export Credit Finance at below 7%, and have provided that no more than a third of it can be in a currency such as Swiss francs where low commercial rates are available. At least half the credit must be in the currency of the bidder, which means that Babcock cannot use low interest currencies such as DM or Yen to get closer to the 7% requirement; their German and Japanese competitors will, of course, be able to do so. This makes it all the more likely that they will be able by one means or another to meet the Korean condition, as explained further below. Babcock's position is all the more difficult in that ECGD supported an offer of 6% finance for Davy for the blast furnace contract of this project, which they won; and POSCO will inevitably have a strong expectation that we will do the same again.

The terms agreed for the earlier Davy bid were justified by the perceived need to match the Austrians who were known to have offered a mixed credit package for earlier parts of the projects and refused to give ECGD assurance that they would not repeat them for the blast furnace. This later led to some international recriminations as the Austrians claimed that they had never intended to bid for the blast furnace. The Japanese were particularly annoyed at what they saw as ECGD's trigger happiness.

Against this background international consultation for the later bids is being conducted with the utmost care. There is no justification that the Austrians are competing this time, and ECGD has very clear assurance from the other authorities involved that they will not give

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official support to under cut Consensus interest rates (10.7% for sterling and dollars but lower for currencies such as DM and Yen which have lower commercial rates).

The Germans have notified that they are supporting 12 years credit and ECGD is prepared to match this; but to go further would be to take the lead in undermining international discipline on these matters, which we have laid great stress on upholding.

It seems likely that the Germans and Japanese may offer "cosmetic interest rates", ie "the lower apparent rate to the buyer than they are having to pay for their loans". The balance would of course have to be absorbed in some way by the suppliers, probably as an addition to their price. ECGD has offered to consider a similar arrangement to Babcock Moxey but this is not feasible for them, as the higher cost of subsidising sterling down to the Korean required level (at least £4m) would certainly make them uncompetitive.

DTI officials have considered two alternatives to support Babcocks; use of the ATP budget, and the use of the Industry Act. Both face serious objections which would need Ministerial decision, and have not so far been pursued inter-departmentally. We cannot identify any other possibilities.

ATP Grant

Korea is in principle eligible for ATP, but to use it in this case would raise substantial policy objections:

- (i) Initiation of an Aid offer in a market where mixed credits have traditionally not been used. This would in particular encourage the Japanese to use their extensive Aid Programme to support their pursuit of various elements of the Pohang project, thus starting a race against a more generously equipped adversary.
- (ii) The use of Aid in support of a steel plant contract would risk provoking a serious protest from the US government which is seeking to outlaw the use of concessional finance for steel projects, in view of world steel over capacity.

Section 7 of the Industry Act

We expect that if Babcock win this contract, substantial work will be provided for sub-contractors in regional development areas. This means that support could in principle be given under Section 7 of the Industry Act. This would be a most unusual (though not unprecedented) use of the Act, and would require the authority of

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Ministers. The principal difficulty is that it would undoubtedly be regarded as a breach of our European Community obligations, and so open to challenge if it were to become known.

Other UK Bids

A further complication, if any of the above courses were to be followed, is that other UK companies are bidding for other contracts which are part of this project, and have yet to be awarded. They would undoubtedly seek similar treatment, and have indeed already been in touch with the Department.

Other Support

Babcock and the other companies that have bid for POSCO contracts have received strong diplomatic support from our Ambassador in Seoul. The Minister for Trade will be in Seoul early in March at a crucial time in the evaluation of these bids when he will lend his support at the political level.

Nevertheless, Babcock's fears that they have no chance of winning the contract unless they can meet the Korean conditions on finance are undoubtedly well founded. But the options open to us to support them all present such serious difficulties as to require clear Ministerial endorsement before they could be pursued.

*Yours sincerely*

*Martin Bond*

MARTIN BOND  
Assistant Private Secretary to  
The Minister for Trade (PAUL CHANNON)

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COOPERATION

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