DEPARTMENT OF TRADE 1 VICTORIA STREET LONDON SW1H 0ET Telephone 01-215 7877

From the Secretary of State

We must keep this contract. First - go for Jobert and tell him if there is any difficulty that I will deal direct with M. Mitterrand. If no satisfaction - we will take the power plant here. MT.

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John Coles Esq
Private Secretary
10 Downing Street
London, SW1

11th February 1982

Dear John,

INDIA: ORISSA STEEL PLANT: FRENCH AID SHORTFALL

As promised in Nick McInnes' letter of 5 February to Mike Pattison, I am writing to give you a progress report on the Orissa steel plant.

In view of the length of this letter, it might be helpful if I summarise the main points:-

1 There is a shortfall of about £32m in the amount of aid (soft loans) which the French authorities are now willing to offer compared with that originally promised by the French companies involved in the Davy consortium.

2 The Indian government, though pre-disposed towards the Davy bid, wish this shortfall to be made up. If it is not, it is possible that Davy's rivals (Demag) would be allowed to make a successful counter bid.

3 My Secretary of State therefore proposes that:-

(i) we seek to persuade the French authorities to make good the £32m shortfall or accept a reduction in French content;

(ii) if the French refuse to increase the amount of soft loans, the United Kingdom be prepared to offer a further £10 m of grant aid to the Indian government with the hope that £5m might come from the existing bilateral aid programme. This would result in an extra £50-60m of business for United Kingdom companies.

4 My Secretary of State therefore seeks colleagues' agreement to the above proposals.

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From the Secretary of State

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Background

The United Kingdom led (Davy) bid for this £1.2 billion project - where the United Kingdom content is now £600m - included a major French component (comprising all the high technology electrical equipment and coke ovens) amounting to £210m (F Francs 2.3 billion). This French component had been included from 1979 onwards despite the strenuous protests of GEC and Babcocks, because the French were offering export credits and aid; at that stage we were not prepared to offer more of either. At the stage the final bids went in, the French companies confirmed that the (French) soft loans would amount to £105m (F Francs 1.15 billion) which is equivalent grant aid of about £73m.

105

Recent developments

At the end of last year (subsequent to the award of the letter of intent) the French authorities indicated to the Government of India (GoI) that no more than £44m (F Francs 450m) of soft loans would be available - ie a shortfall of 700m F Francs on soft loans. The GoI made it clear to Davy, and ourselves and the French that the financial package of the Davy bid was a crucial factor in the decision to award the letter of intent. The shortfall in French soft finance would therefore throw in question the letter of intent.

44

We put pressure on the French authorities to increase their aid offer, and in the course of negotiation, including a review of the historical sequence, the French officials admitted that the French companies had not sought or received authority (from the French government) for the size of the aid package which they put forward to Davy, and that there were severe financial constraints. They however recognised that the fault lay with the French side as a whole and agreed to return to their Ministers for an increase in aid. They also accepted that to the extent that there was a French soft loan shortfall there would have to be a proportionate reduction in French content.

The French have now indicated that they are prepared to increase their soft loan to £73m (F Francs 800m), but on the condition that the French content stays unchanged. They have stated that this is their final offer. The resulting soft loan shortfall is £32m (F Francs 350m) which is equivalent to £23m aid grant under our aid conventions. The GoI has now informed the French that they do not regard this as sufficient. However they have made clear to Davy and ourselves that it is Davy's responsibility to come forward

73

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with financing proposals which make good the shortfall and, if necessary, change the pattern of sourcing. The GoI has emphasised their strong pre-disposition to continue with the United Kingdom led bid, but is under considerable pressure from Demag (Davy's rivals) and their supporters who are exploiting the situation.

Negotiations between Davy and the Indian authorities have been proceeding satisfactorily on other aspects and their objective is to enter into contractual commitments by 15 May (the export credits deadline). Any delay in resolving this financing problem would not only jeopardise this deadline, but more importantly increase Demag's scope for a successful counter bid.

Objectives and implications

In these circumstances, my Secretary of State considers that our prime objective must be to resolve this problem with the minimum impact on the existing pattern of sourcing and finance. This means attempting to persuade the French authorities to increase their soft loan offer to the figure of £105m originally indicated by the French companies, or, failing that, to ensure that the French accept that the French content should be reduced proportionately by £64m (F Francs 700m). This would enable substitute soft finance to be organised for the equipment released. The French are clearly discomforted by the adverse Indian reaction, and could find this alternative a reasonable way out. The most readily detachable component of the French package is the captive power plant for the steel complex.

If we can persuade the French to give up the power plant, Davy's strong preference would be to source it out of the United Kingdom. This would minimise the delay, and also give a consolation prize to United Kingdom companies - GEC or NEI - who were not included in the United Kingdom proposals. In theory, Davy could also source this power plant from other countries - eg Italy or Romania, but to do so, would involve yet another national supplier and government. The negotiation of financing offers, prices and performance requirements could jeopardise the already complex contract negotiations.

Thus, we need to agree now a fall back position if the French are not prepared to stand by the aid offer indicated by their companies. In such a case, the United Kingdom should be prepared to make good the shortfall on condition that there is a transfer of corresponding work content to the United Kingdom from the French. Without this sanction, we should be unable to negotiate with the French with any effective leverage.

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It is not possible to be definite at this stage on the amount of concessional finance which would be required, since this will depend on subsequent detailed negotiations with the Indians. However, our informal indications are that the GoI recognise that this situation is not of our making, and would seek the minimum necessary to defend the package domestically. For us to make good the shortfall could thus be about half the concessional value of the French aid - ie £10m of grant aid. In addition, the GoI might be disposed to accept about half of this reduced amount (ie about £5m) from RTA local costs aid which comes from the existing bilateral programme and hence is not additional aid. Therefore the genuinely additional aid might be no more than £5m spread over four years. In return we would obtain about £50-£60m of additional United Kingdom business.

The Prime Minister will recall that at the time of writing the letter of intent, we were willing to commit additional aid resources for this project, and my Secretary of State recommends that we should negotiate on this basis. Clearly, if we have to contribute further aid, we should aim to keep any additional contribution to a minimum consistent with securing the project.

Immediate steps

My Secretary of State intends to write to M. Jobert, the French Minister for Trade, to express our concern about the problem and to press the French government to make good their shortfall in the proposed soft loans. Simultaneously, the Secretary of State suggests diplomatic pressure be exerted by our Ambassador in Paris.

Copies of this letter go to John Holmes (FCO), Mike Power (ODA), Peter Jenkins (Treasury) and Jonathan Spencer (Industry).

Yours sincerely,

Jonathan Rees

J N REES
Private Secretary

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FILE SW

cc Ind
Treas
Overseas Dev
FCO

16 February, 1982

India: Orissa Steel Plant

Thank you for your letter of 11 February. The Prime Minister has considered its contents and has commented:

> "We must keep this contract. We should first approach Jobert and tell him that if there is any difficulty, I will deal direct with President Mitterrand. If we obtain no satisfaction, we will take the power plant here".

I am copying this letter to the recipients of your letter.

A. J. COLES

Jonathan Rees, Esq.,
Department of Trade

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(1)

10 DOWNING STREET

Prime Minister

Indian Steel Plant

In case you find the figures in the attached letter as confusing as I did:-

£32 million is the difference between the original French soft loan offer and their final offer - i.e. it is the difference which now has to be made up.

£23 million is the equivalent in UK aid grant terms of £32 million of French soft loans.

£10 million is the extra aid which we believe will be necessary to induce the Indians to go ahead (i.e. we think they will not insist on the full £23 million).

2. Content with Mr. Biffen's proposals?

A.J.C. 15/2