



Minister of State
for Defence Procurement

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MINISTRY OF DEFENCE
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27 February 1984

Dear Paul,

You will be aware of a longstanding prospective sale of Vosper Thornycroft frigates to Pakistan for which ECGD credit cover was agreed by Ministers in 1982. It now appears that Vospers are close to concluding a sale but to achieve this a substantial improvement in the credit currently on offer is required.

Briefly the background is that following discussions in OD in June 1982 Vospers were offered 50% ECGD cover for a then contract value of £150m, in the expectation that they would be able to obtain the balance of the finance required from Arab banking sources. Vospers succeeded in obtaining an informal offer of finance from a source in Abu Dhabi on the basis of which they offered the Pakistanis a 100% credit package. The Prime Minister wrote to President Zia in August 1982 supporting the Vospers proposals. This succeeded in improving the company's chances in the face of strong competition from the French and Italians among others. Real progress began to be made last year with the appointment of a new Chief of Naval Staff in Pakistan. Admiral T K Khan has, from the

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The Rt Hon Paul Channon MP

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outset, shown a decided preference for equipping the Pakistan Navy with British ships, and for reviving links with the Royal Navy over a wider front. He has now established a requirement for two Type 21 frigates with a largely British equipment fit. He has obtained the approval of the Pakistani Ministry of Defence and Joint Chiefs of Staff for his proposals. A Ministry of Finance decision on the MOD budget is expected within the next month. Our Ambassador in Islamabad, who has consulted both the Ministry of Finance and the MOD there, confidently expects that a budgetary allocation will be made for purchase of frigates and that Vospers, as the preferred supplier, will be asked for firm credit proposals.

Vospers' current offer of ECGD-backed credit amounts to £75m and expires on 31st March. They have established that they cannot obtain the Arab finance which they had earlier been led to expect and they have been unable to obtain commercial finance from alternative sources. Meanwhile the contract value has increased from £150m to £220m, the increase being largely attributable to the Pakistan Navy's specification of the Type 21 in place of the smaller Mk 7 frigate, and to changes in equipment fit.

Two other proposals have been shortlisted from Germany and France. We understand that Vospers' proposals are cheaper than either of these and are judged by the Pakistan Navy to be well ahead on technical grounds. The Pakistan Navy have reported to us a French offer of 100% credit for two ships with approximately 50% of this Government-backed; the detailed terms are said to be subject to negotiation.

HM Ambassador has been unable to obtain a Ministry of Finance view on their credit requirement other than that it

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should be the best we can offer. He judges, however, that, to remain in contention, we should offer at least 50% of £220m (to match the French) and that we should be prepared to move quickly to match competing offers of up to 70%. Providing we can offer the consensus rate of 9.5% over a period of seven years from delivery we could not envisage a problem over terms. It is the amount of credit on offer which is the key issue.

Vospers have therefore submitted an application to ECGD for cover of up to 70% of a contract value of £220m with proposals from their London bankers to bear a proportion of the risk on principal and interest payments which would reduce ECGD's DML on the loan from approximately £250m to about £217m (further proposals designed to reduce the DML to £126m have, I understand, proved unacceptable to ECGD). The non-UK content of the current package is under 7% compared with up to 40% for the proposals made in 1982. This application is now being considered by officials. Vospers need to have their credit offer ready to present during March.

I do not underestimate the difficulty of agreeing to increased credit on this scale. We have however backed this project for 18 months; Vospers have worked hard on it and are now close to success. I believe we must now give them the credit support that they require to close the deal. The wider arguments for our support are no less strong than they were when OD last considered the matter. Norman Lamont may wish to comment on the industrial issues at stake and their implications for our hopes to privatise the warship building yards. I touched on these in my letter of 8th February to Peter Rees about credit for fast patrol craft for Kenya.

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Fast patrol craft orders would not, of course, affect Vosper Thornycroft's Woolston Yard at Southampton which will, I understand, have to run down in 1985 to a GRP facility with a loss of up to 2,000 jobs if further frigate orders are not obtained.

In all honesty, I have to say to you that there is no strong likelihood of a RN frigate order for Vospers in the foreseeable future. The only immediately available frigate orders are for two further Type 22s for which there are no price, procurement or privatisation arguments running in favour of Vospers at the expense of either Cammell Laird or Swan Hunter which are also competing for this order. In short, the Pakistani frigates represent a lifeline for continued steel warshipbuilding at Vospers.

Moreover, this would be the most significant warship export order since Vospers sold the Ramadhan class FPBs to Egypt in 1978 and the first export of warships of this size since the Type 42s and Mk 10 frigates were sold to Argentina and Brazil in 1970. It could open the way for further warship business. The Pakistan Navy hopes to procure further frigates possibly built in Karachi with Vospers' assistance. Pakistan's close naval links with Saudi Arabia and the Gulf States would enhance our sales prospects in that area.

This deal would also add substance to our defence relations with Pakistan and provide tangible evidence of our support. There are important defence and foreign policy considerations there, because of the strategic position which Pakistan occupies and her role in the Afghanistan conflict.

In summary, any risks in extending our credit exposure in support of this order have to be measured against important

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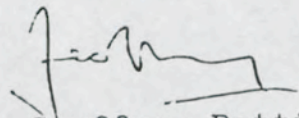
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commercial, industrial, employment, defence and foreign policy considerations, as well as the prospects for effective privatisation of the warship building yards.

I felt you should have early warning of these issues. Time is pressing and I hope that officials can reach early agreement in EGC or, if that is not possible, that the matter can be referred to OD again quickly.

I am copying this letter to Norman Lamont, Peter Rees, Peter Morrison, Lady Young and to Sir Robert Armstrong.

You will recall the support the Prime Minister gave to the provision of sufficient credit to win the order, despite the risks, when it was considered at OD 20 months ago. The industrial case for support is even stronger now than it was then. A lot of money has been spent since

for me

Geoffrey Pattie