

CONFIDENTIAL



FROM: CHIEF SECRETARY  
DATE: 1st August 1984

*Await views  
Mr Tebbit  
CDP 2/2*

PRIME MINISTER

## ECGD COVER FOR PAKISTAN

At its meeting on 28 March OD Committee agreed - on an exceptional basis and without prejudice to the Government's general policy of reducing ECGD's exposure in countries whose creditworthiness was in doubt - to provide an increased level of credit cover to meet the higher than expected cost of the frigates to be sold to Pakistan. The Committee also invited Norman Tebbit and me to determine how this increased cover could best be provided. This reflected the Committee's concern about the impact on other potential business of the additional £214 million of exposure to cover the frigates.

The present position is that the £75 million market limit for medium and long term business on Section 2, the national interest account, remains unaffected by the £214 million of exceptional cover for the frigates. The latter has been given outside the limit and is available only for that purpose. At the time of the OD discussion a small part of the £75 million remained uncommitted. That has now been utilised for business other than the frigates. By making the exceptional credit cover available outside the limit I believe that we have protected cover for civil business to the maximum consistent with our general policy. Some enquiries for cover may have to be turned away. This is an inevitable consequence of the policy that we have quite rightly adopted in response to the debt situation of a more rigorous approach to setting limits on ECGD's exposure in riskier markets.

However, in taking forward the further OD remit, Norman Tebbit has suggested that a further increase in the Section 2 limit to support on-going civil business could be provided by transferring the accounting responsibility for the potential liability on the frigates off ECGD's trading account, leaving it to some other Department to meet any losses incurred.

I have considered this suggestion very carefully but believe that the objections are overwhelming.

The original commitment to provide cover for these frigates was given on industrial grounds - the need to provide work for Vosper Thornycroft's yards. The agreement to provide additional cover was given because to do otherwise would have meant reneging on a commitment given to President Zia. We were, however, in no doubt about the prudential arguments against extending cover of this magnitude to Pakistan. Transferring the risk out of ECGD's trading accounts onto some other Government account would

CONFIDENTIAL

not improve Pakistan's ability to pay. Moreover, however the liabilities are treated for accounting purposes, it is the Exchequer which ultimately takes the risk and the need to protect it by restricting business for prudential reasons remains the same.

In addition, taking the liabilities off the Department's trading account and thus outside the constraint of operating at no net cost to public funds could lead to a deterioration in the control of export credit liabilities which would be inconsistent with the policy to which we are committed and which OD reaffirmed in March.

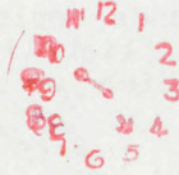
I have also considered whether recent developments in the Pakistan economy would enable us to take a less restrictive attitude towards credit on this market. They do not. In the year ending in June 1983 there was a narrowing of the current account deficit as a result of increased emigrant remittances. But the external account remains fundamentally weak and critically dependent on the level of such remittances which exceed Pakistan's export earnings. In the year which has just ended the current account deficit is expected to have doubled and to remain very vulnerable eg to troubles in the Gulf. Thus, even without the additional exposure on the frigates, I would not have felt it right to endorse an increase in the £75 million market limit. Whilst our potential exposure including the frigates remains considerably greater than this - £290 million - it would be quite irresponsible to increase the limit further. If the frigates deal falls through, we can look at the position again in the light of the then prevailing economic conditions, but for the time being I believe that the limit of £75 million is as far as we can prudently go. Further cover, outside the short term, should therefore only become available as existing commitments are run off.

I am copying this minute to Members of OD.

  
P R

Defence Jones Pt 4

2 AUG 1984



PETER RINT

CONFIDENTIAL

PRIME MINISTER

2 August 1984

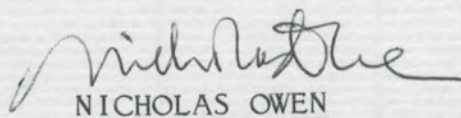
ECGD COVER FOR PAKISTAN

We recommend that you support the Chief Secretary's efforts to hold the credit limit to Pakistan at £75 million.

We have already moved way beyond financial prudence by, in effect, giving Pakistan two frigates.

ECGD are putting in an additional bid of £180 million next year, arising largely from miscalculations about interest support costs. The Nigerian debt problem will add a further £200 million to the PSBR this year, rising to a total of £500 million next year. Had Nigeria done a deal with the IMF these costs to the PSBR would have been avoided.

ECGD's contingent liabilities are over £40 billion and could easily lead to further costs. Departments are considering how ECGD could be managed better: there will be a report following The Matthews Committee investigation. We need to find a way for ECGD to resist the pressures to increase its credit limits to countries unlikely to pay. A first step is to turn down this DTI proposition.

  
NICHOLAS OWEN

CONFIDENTIAL



10 DOWNING STREET

cc DTI  
CS&HMT  
FCO  
LCO  
HMT LPS  
LPO CD of L  
MOD CO.  
bc PE.

*From the Private Secretary*

28 July 1984

FRIGATES FOR PAKISTAN

The Prime Minister has considered Mr Pattie's letter of 26 July to Lord Cockfield and Mr Tebbit's letter of 27 July to Mr Pattie.

The Prime Minister hopes that agreement can be reached speedily between the Ministry of Defence, the Department of Trade and Industry and the Treasury on the basis of the compromise proposal in Mr Tebbit's letter, which she favours.

BF /

I shall be grateful if you would keep me informed. I am sending copies of this letter to Callum McCarthy (Department of Trade and Industry), John Gieve (Chief Secretary's Office, Treasury), Colin Budd (Foreign and Commonwealth Office), the Private Secretaries to other members of OD and to Richard Hatfield (Cabinet Office).

Charles Powell

Dr A S Kemp  
Ministry of Defence

PRIME MINISTER

Frigates for Pakistan

- A. President Zia wrote to you on 5 July about the likely purchase of the Vosper Thornycroft frigates for the Pakistan Navy.

You will recall that OD agreed on a substantial credit offer for this sale of 70 per cent on £200 million. Following negotiations with

- B. Admiral Khan of the Pakistan Navy, the MOD have proposed that the credit offer be improved by an increase of principal of £20 million, in order to clinch the sale. The MOD believe that the French and Germans are offering better terms than those agreed in OD.

- C. Mr. Tebbit does not believe that this improved offer is justified and doubts whether the French and Germans are, in fact, offering better terms. He would be ready to agree, however, that, if the additional £20 million can be raised with private sources taking the payment risk, he would authorise ECGD to include this amount in their interest make-up arrangements for the contract.

The MOD say that other members of OD, apart from the Chief Secretary and perhaps Lord Cockfield, are content with their original proposal.

Agree to say that you hope that agreement can be reached speedily between DTI, Treasury and MOD on the basis of Mr. Tebbit's compromise proposal, failing which you will chair a meeting to try to settle it?

C. D. P.  
C. D. POWELL  
27 July, 1984

*Yes*



afc  
NBP7  
COD

31/7.

Treasury Chambers, Parliament Street, SW1P 3AG

Geoffrey Pattie Esq  
Minister of State for Defence Procurement  
Ministry of Defence  
Whitehall  
London SW1A 2HP

30 July 1984

*John Geoffrey*

FRIGATES FOR PAKISTAN

I have seen your letters of 20 and 26 July seeking an increase in the amount of cover which OD agreed should be made available for this deal. I have also seen Norman Tebbit's reply.

2. I entirely share Norman's view that OD's agreement to provide £215 million of additional cover for this deal represents the maximum that we could consider. Indeed, in agreeing it the Committee fully recognised that it went further than was justified on grounds of prudence. In the light of this, I was surprised to see the line you took in talking to Admiral Khan earlier this month.

3. However, in further recognition of the political commitment which lay behind the OD decision, I would be prepared to agree the compromise put forward in Norman Tebbit's letter i.e. that if private funds can be found to take the additional risk, we should provide interest make up on the total sum, despite the additional public expenditure involved.

4. I am copying this letter to Norman Tebbit, to the other members of OD and to Sir Robert Armstrong.

*John W. Rees*

PETER REES

PAKISTAN: Relations  
Apr 79

31 JUL 1979

10  
11  
12  
13  
14  
15  
16  
17  
18  
19  
20  
21  
22  
23  
24  
25  
26  
27  
28  
29  
30  
31





DEPARTMENT OF TRADE AND INDUSTRY

1-19 VICTORIA STREET

LONDON SW1H 0ET

5422

Telephone (Direct dialling) 01-215

GTN 215

(Switchboard) 215 7877

Secretary of State for Trade and Industry

27 July 1984

CONFIDENTIAL

Geoffrey Pattie Esq MP  
Minister of State for Defence  
Procurement  
Ministry of Defence  
Main Building  
Whitehall  
LONDON  
SW1A 2HB

*D. Geoffrey,*

FRIGATES FOR PAKISTAN

Thank you for your letter of 20 July about Pakistan frigates.

2 I note your view that the offer of an additional £20m credit would probably clinch this deal for Britain. However, as you know, the decision to make the existing offer of £150m credit was a very difficult one. I believe OD would rightly take the view that an exceptionally strong case would be needed to justify going even further.

3 The best evidence available to us at present does not confirm the suggestion that the French and German authorities are supporting better credit offers than our own. ECGD have made fresh checks: the French say they are supporting only two frigates with credit for 70 per cent repayable over seven years, and the Germans say they are not providing official support - which is in line with their standard policy for arms sales to non-NATO countries. While there can naturally be no guarantee that this represents the final position of our competitors, experience suggests that this type of information is usually more reliable than that obtained from buyers, who have an obvious interest in giving optimistic versions of what they hope to get from competitors.

4 Against this background, I doubt whether a case can be made for increasing our own official support in the way you suggest. However, if the additional £20m can be raised with private sources

JH2AVK



taking the payment risk I should be willing, provided colleagues agree, to authorize ECGD to include this amount in their interest make-up arrangements for this contract.

5 I suggest Vosper Thornycroft should be pressed to make every effort to set up an arrangement on these lines.

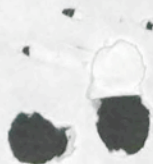
6 I am sending a copy of this letter to the members of OD and to Sir Robert Armstrong.

A handwritten signature in dark ink, appearing to read 'Norman Tebbit', with a stylized flourish above the name.

NORMAN TEBBIT

PAKISTAN: News

Sept 77



~~CONFIDENTIAL~~  
CONFIDENTIAL

~~CC PE~~



Minister of State  
for Defence Procurement

MINISTRY OF DEFENCE  
WHITEHALL LONDON SW1A 2HB

Telephone 01-218 6621 (Direct Dialling)  
01-218 9000 (Switchboard)

D/MIN/GP/3/8

26 July 1984

*Dear Sir*

FRIGATES FOR PAKISTAN

Thank you for your letter of 24th July outlining the lead up to the offer now on the table seeking guidance on the effects of my proposal.

Your account of the record to date is accurate so far as it goes. The table at Annex sets out the position. You have asked to know the effect of my proposal on ECGD exposure. The ECGD commitment is in two parts, the subsidy and the indemnity. The subsidy relates to ECGD's funding of the difference between their interest rate of 9.5% and the prevailing commercial rate. This element of interest subsidy would be applied to the interest portion of the DML. The commercial rate will vary over the period of the loan, but as a rough indication, the subsidy would amount to approximately 4% at today's rates. This commitment is therefore relatively small, the main issue being the level of indemnity against repayment default.

Such indemnity covers both principal and interest repayments which combine to give ECGD's total exposure, the

/ maximum ...

The Rt Hon The Lord Cockfield

~~CONFIDENTIAL~~  
CONFIDENTIAL

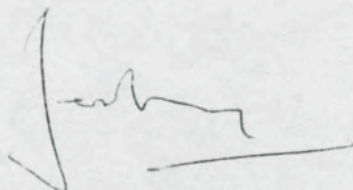
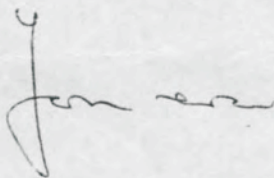
~~CONFIDENTIAL~~ CONFIDENTIAL ~~CONFIDENTIAL~~

2

maximum limit of which being the DML. The relationship between principal and interest is complex, but ECGD would normally expect the interest to add about ~~40%~~<sup>50</sup> to the principal. (It so happens that it is only 40% on the existing offer). My proposed increase of £20m could thus entail up to a further £10m interest, so that the DML, which has for some time been set at £215m, would rise to a figure between £235m and £245m.

I am proposing that approval be given for an increase of DML within these limits so that ECGD can then agree with the banks the actual level of interest to be indemnified. It would then be possible for the Prime Minister to respond positively to President Zia's letter with an increase of principal of £20m. This would not need to await the outcome of discussions between ECGD and the banks. It should be noted that Admiral Khan, who delivered President Zia's letter to the Prime Minister, returns to Pakistan at the end of the week. I should therefore be grateful for colleagues approval for the proposed reply by then.

I am copying this letter to the members of OD and to Sir Robert Armstrong.



Geoffrey Pattie

~~CONFIDENTIAL~~ CONFIDENTIAL ~~CONFIDENTIAL~~

# CONFIDENTIAL

ANNEX TO  
D/MIN/GP/3/8  
DATED: 26 JUL 84

The construction of the current and earlier offer is given in the table below. There are fourteen six-monthly payments covering both principal and interest. The banks have agreed to accept the risk on the first two payments, with ECGD indemnifying the remaining six/seven of the principal. The interest indemnified by ECGD is simply the difference between the indemnified principal and the overall DML agreed. This limited interest indemnity would apply to the later payments though ECGD would of course be providing commercial equalisation subsidy on all interest.

	<u>Previous</u>	<u>Current</u>	<u>Proposed likely ECGD worst-case</u>
a. Number of frigates	2	3	3
b. Total value	£220m	£300m	£300m
c. Principal at ECGD risk (12/14)	£132m	£154m	£171m
d. Principal at bank risk (2/14)	£ 22m	£ 26m	£ 29m
e. Total principal (c. + d.)	£154m	£180m	£200m
f. Total principal as % of total value (e. ÷ b %)	70%	60%	67%
g. Total ECGD risk or DML	£215m	£215m	£235-£245m
h. Interest at ECGD risk (g. - c.)	£ 83m	£ 61m	£ 64-74m

CONFIDENTIAL

Pakistan

Sept 79

Relativity

26 JUL 1984

11 12 1  
1984  
11 12 1

*4 PC*



CABINET OFFICE,  
WHITEHALL, LONDON SW1A 2AS

Chancellor of the Duchy of Lancaster

24 July 1984

*Await answer*

*Dear Geoffrey,*

FRIGATES FOR PAKISTAN

I have seen a copy of your letter of 20 July to Norman Tebbit.

It would be helpful if we could be told what the figures are and how they are calculated. What the record shows is as follows:-

1. The 1982 offer was 50% on £150 m viz £75 m.
2. The OD minutes of 28 March 1984 say we agreed 70% on £220 m viz £154 m.
3. You now say that our offer was 60% equal to £180 m. The £180 m is apparently based on the enhanced cost of £300 m.
4. You now want to increase this to £200 m.

The first question which needs to be answered is how did we get from 70% on £220 m (equals £154 m) to which OD agreed, to £180 m - however that figure might be calculated?

The second question is what is the amount of (a) the subsidy and (b) the DML in the case of the present proposition?

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

*[Signature]*  
*[Signature]*  
COCKFIELD

G Pattie Esq MP  
Minister of State for Defence :  
Procurement  
Ministry of Defence  
Main Building  
Whitehall  
London SW1Z 2HB



PAKISTAN: Relations  
Sept 79



24 JUL 1984



~~CONFIDENTIAL~~

~~COMMERCIAL IN CONFIDENCE~~

CEPC

BF

Await comment  
from STS.



D/MIN/GP/3/8

20 July 1984

Dear Secretary of State,

FRIGATES FOR PAKISTAN

As you know, the Pakistan Chief of Naval Staff, Admiral T K Khan called on me yesterday to discuss the prospects for the sale of three Type 21 frigates to Pakistan. Admiral Khan emphasised how determined the Pakistan Navy were to preserve their links with the Royal Navy and referred to the letter of 5th July to the Prime Minister (copy attached) that Admiral Khan had delivered to the Foreign Office on behalf of President Zia.

Admiral Khan said that however decided the Pakistan Navy was on its choice, the final decision, which would be taken before 15th August, rested with the Ministry of Finance. The question of finance, and more particularly of credit, was therefore crucial. He asked if we would increase our ECGD-backed credit cover, in order to make sure of the deal (worth £300m).

Admiral Khan quoted the French and German offers which according to him were better than ours. On the other hand he admitted that the German offer (reportedly 85% of the cost of

/ three ...

The Rt Hon Norman Tebbit MP

~~CONFIDENTIAL~~  
~~COMMERCIAL IN CONFIDENCE~~

three frigates at 9% over seven years from mean delivery) was in Deutchmarks which in the longer term would prove a more expensive loan than a commercial rate quoted in sterling. He said that the French offer was 90% of the cost of three ships at 9.5%, and therefore more generous than our own proposal of £180m at 9.5%, or 60% of the total cost of the deal (which, you will recall, was agreed at the meeting of OD on 28th March). ECGD's information is that the French offer is in fact 70% of the cost of two frigates plus 20% at commercial rates. It is very possible, however, that the French may have increased their offer in the past few days to cover three ships.

Having met Admiral Khan, I believe that a token gesture to meet the Pakistan Navy's wishes would secure this valuable deal for Vosper Thornycroft. Another £20m of UK credit, raised either through an extension to £170m of the present ECGD offer or by means of private finance at a subsidised rate of interest, would take the UK offer to £200m and, in my view, have great presentational advantage. Moreover, it would enable the Prime Minister to reply positively to President Zia.

Accordingly, in Michael Heseltine's absence, I am writing to seek your agreement to an increase in the level of UK credit to £200m. I also attach a draft reply from the Prime Minister couched in appropriate terms which, if colleagues agree, Admiral Khan could take back with him to Islamabad at the end of his visit (about 26th July).

The importance of this deal is considerable, principally on account of the export work it would bring to Vospers' yards, the involvement of a wide range of British manufacturers, the long term consequences for the orientation of the Pakistan Navy and for the prospects for British equipment sales to the Gulf region as a whole (which is heavily dependent on Pakistani

/ military ...

military assistance). I believe that we should not let this opportunity slip given the genuinely favourable disposition of the Pakistanis, as illustrated by President Zia's letter.

I am copying this letter to the members of OD and to Sir Robert Armstrong in the hope that we can reach a speedy agreement on the terms of the attached draft.

*Atankemp*

ps / Geoffrey Pattie

(Approved by the Minister  
and signed in his absence)



MINISTER OF STATE FOR DEFENCE  
PROCUREMENT

D/MIN/GP/3/8

20th July 1984

Note of a meeting held in the office of  
the Minister of State for Defence  
Procurement at 10.45am on  
19th July 1984

Present:

Mr Geoffrey Pattie MP  
Minister of State for  
Defence Procurement

Admiral T K Khan NI(M)  
Chief of the Naval Staff,  
Pakistan Navy

Mr A Harris  
Regional Marketing  
Director 1

Captain M F A Khan  
Naval Attache'  
Pakistan Embassy, London

Dr A S Kemp  
PS/Minister (DP)

Admiral Khan said that, following his official visit, he was having more detailed talks on the Pakistan Navy's (PN) requirement for three frigates, for which there was a competition between the United Kingdom, France and Germany.

2. The Admiral explained that following Vospers' impressive presentation in Pakistan of the Type 21, both the French and the Germans had sought to undermine the British position. They had called into question the stability and structural integrity of the Type 21 and had made attractive financial offers for their own designs. This was worrying for the PN which continued to favour the British ship, but which recognised that the choice of vessel lies ultimately with the Pakistan Finance Ministry. Speaking candidly, the Admiral said that the French and Germans had been more imaginative in their marketing and in particular in their approach to finance. In comparison, the UK seemed slow and traditional; neither the French nor the Germans expected, for example, Pakistan to sign a Letter of Intent before making their best offers. Admiral Khan said that he had made these points both to CNS and HDS. In

/ summary ...

~~CONFIDENTIAL~~  
CONFIDENTIAL

2

In summary, as a result of his visit so far, the UK had been able to provide the ammunition necessary for the PN to defeat the technical criticisms which had been made of the Type 21, which were largely unfounded, but he remained concerned at our relative inflexibility over finance.

3. Responding, Minister (DP) said that the PN could rely upon the MOD to provide all the technical and overseeing assistance required to ensure that the Type 21 entered service satisfactorily. He also believed that the UK would be able to put together an attractive training package. (Admiral Khan made it clear that he valued highly the involvement of the MOD in this way and asked for a suitable MOU to be established. This was agreed). However, Mr Pattie said that he could not pretend that it would be easy to improve the present, very attractive, ECGD-based terms which were being offered on the Type 21s. The UK, he said, remained as keen as ever for the sale to go ahead. The Prime Minister, as she had indicated to President Zia, was taking a personal interest. Clearly, it was important to develop relations between two highly professional Navies; there was no better way of promoting this than through the use of common equipment, approaches to training and tactical doctrine. All that said, he believed the UK was approaching the limits of what could be offered financially, although he would be prepared to examine with colleagues whether anything more might be done.

4. Admiral Khan said that he appreciated this, adding that he was genuinely fearful that, if the order went to France, his Navy would be wholly dependent on the French upon whom, following the decision by the Wilson Government in 1966 not to sell Oberon submarines to Pakistan, the PN was already heavily dependent.

5. Mr Pattie said that this would indeed be regrettable, but hoped this would not be allowed to happen.

*Alan Kemp*

(A S Kemp)  
PS/Minister)(DP)

---

/ Distribution ...

~~CONFIDENTIAL~~  
CONFIDENTIAL

D/MIN/GP/3/8

Distribution:

APS/Secretary of State  
Sec/CNS  
PS/HDS  
ACNS(OR)  
DG Mktg  
RMD 1

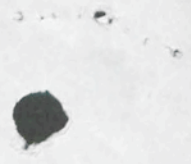
David Barclay Esq.,  
PS/Prime Minister

H B Warren-Gash Esq.,  
PS/Mr Richard Luce MP

M C McCarthy Esq.,  
PS/Secretary of State for  
Trade and Industry

D J Normington Esq.,  
PS/Secretary of State for  
Employment

DEFENCE  
Sales



DEFENCE  
Sales