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P. 01235

PRIME MINISTERGuangdong Nuclear Power Station

(EX(84)3)

BACKGROUND

The People's Republic of China are proposing to build a nuclear power station of the pressurised water reactor (PWR) type to supply electricity both to the Guangdong province and to Hong Kong. In March 1983, a memorandum of understanding was signed with the Chinese government naming General Electric (GEC) as supplier of the conventional turbine "island" for the power station subject to the Chinese being satisfied on price, financing and certain other matters. A similar memorandum was signed in May 1983 naming the French company Framatome as suppliers of the nuclear "island".

2. There has for some time been an understanding between the UK and French governments, most recently confirmed at the Anglo-French Summit on 20 October 1983, that they will co-operate as partners on the Guangdong project. But behind the scenes, Electricité de France, who have been appointed as overall architect engineers for the project, have been manoeuvring on behalf of Alsthom Atlantique, Framatome's usual partner, to open up the possibility of their taking over the contract for the conventional turbine, for example, by raising doubts about the new GEC design and pointing to Alsthom's good record with an established turbine. The French government must be aware of their activities. GEC thus remains the front-runner: but there is a potential competitor in the background.

3. General Electric (GEC) are required to bid on 15 March for the conventional turbine contract, worth about

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£435 million. The Government is able to support the bid in two ways: by giving financial assistance to GEC which will enable them to price more competitively, and through the export financing terms made available to China.

Concessions can be offered on export credit in the form of an interest rate below commercial levels; no repayment of principal, till the power station is commissioned; capitalisation of interest payments due as the loan is drawn down prior to commissioning; and support for local costs.

4. In preliminary negotiations, the Government authorised an export credit package for either a sterling or dollar loan as at item 1 in the annex to the memorandum EX(84)3. The total level of concessionality was 15 per cent for a sterling loan and 19 per cent for a dollar loan. On 26 November 1982 (your Private Secretary's minute to the Private Secretary: Secretary of State for Industry), you agreed that the form of the package but not the terms might be changed as at item 2 in the annex. But, it did not prove necessary to make that offer to the Chinese; and our outstanding offer is as at item 1.

5. The French have also offered concessionary export credit terms on the nuclear "island"; their formal bid submitted on 15 February broadly matches the most recent UK offer for the conventional island in terms of total concessionality. China has however been pressing the French for improvements to that offer, such as making the loan available in French francs. China is also pressing the UK to make a better opening offer on 15 March on export credit for the conventional turbine, given GEC's lack of experience on PWR technology.

6. In his memorandum, the Secretary of State for Trade and Industry seeks the Committee's agreement:

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- that the UK should match the opening French offer on both the form and terms of export credit concessions attached to the GEC bid;
- that in subsequent negotiations, he should be authorised to offer further concessions up to a total of 30 per cent of UK contract price;
- that, within the limit, financial assistance up to £4.4 million should be given to GEC through:
 - a. a 33 1/3 per cent (the maximum) grant for the development costs under the Support for Investment (SFI) Programme, amounting to £3.4 million;
 - b. £1 million from the Northern Ireland Development Board (NIDB) for project work at Larne (if the Board and the Secretary of State for Northern Ireland so decide).

MAIN ISSUES

7. The Sub-Committee will wish to consider:
 - i. what should be the opening offer to China on the export credit terms;
 - ii. whether domestic financial assistance should be made available to GEC so as to improve the competitiveness of their bid;
 - iii. how far the Government should be prepared to go in offering further concessions on the export credit terms for the GEC contract.

Opening offer

8. It seems unlikely that there will be disagreement over the opening offer. Mr Tebbit is asking only that, in order to

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bring our offer into line with the French offer on the nuclear island, we should give the Chinese the choice between support for local costs and capitalisation of interest payments, ie the choice between Item 1(a) and Item 2(a) in the Annex. You already authorised this in November 1982.

Domestic financial assistance to GEC

9. It also seems unlikely that there will be objection to the proposal to improve the offer in due course by about 1 per cent by providing support to GEC of £3.4 million under the SFI programme and, subject to the views of the NIDB and Mr Prior, £1 million in respect of project work at Larne. We understand that the Chancellor of the Exchequer is attracted to this course. There are advantages in terms of containing total public expenditure if support for this project is channelled through cash-limited programmes like the SFI, rather than through the open-ended export credits programme. However the Treasury are anxious that a successful company such as GEC should be seen to help win the project; consequently they will seek assurances that any Government assistance goes, so far as possible, to reduce the bid price rather than increase GEC's profits.

Negotiating limit

10. The contentious issue is therefore the limit to be set on further improvements to the offer. Mr Tebbit proposes an overall limit of 30 per cent, ie a subsidy around £130 million. You will wish to establish clearly that this is (as his paragraph 14 suggests) intended to include the 1 per cent domestic financial assistance to GEC; his paragraph 12 implies an offer on the lines of item 5(b) in the Annex amounting to 30.56 per cent with an additional 1 per cent making 31.56 per cent in all.

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11. The Chancellor of the Exchequer will argue that the level of concessionality on offer (14-19 per cent) is already excessive, in relation to the export credit threshold (11.25 per cent) agreed earlier between departments for general lending to China. He is likely to propose that the limit on concessionality should be no higher than 22 per cent, and that this should be regarded as the final limit which should not be exceeded in any circumstances.

12. The Committee will want to weigh the extent of the proposed subsidy against the political and economic benefits of the project. Although it would be realistic to provide some room for further negotiation, it may be tactically unwise at this stage to give the negotiators leeway to move from an opening offer with a subsidy in the range 14 to 19 per cent, to an offer of 30 per cent subsidy. The right course at this stage might therefore be to fix a provisional limit (including the domestic support for GEC) at a considerably lower figure than 30 per cent - either at 22 per cent, which the Chancellor may propose, or perhaps 25 per cent. The negotiators should then make every effort to settle within that limit, although it would, as always, be open to Mr Tebbit to come back to the Committee if some further marginal improvement appeared to be necessary to conclude the negotiations.

Contacts with the French

13. Whatever may be decided about the negotiating limit, the Committee may feel that there would be advantage in putting diplomatic pressure on the French not to escalate export credit subsidies to the Chinese and to hold to the established understanding on the sharing of the Guangdong project. It might be left to the Foreign and Commonwealth Secretary and the Secretary of State for Trade and Industry to consider how this might best be done.

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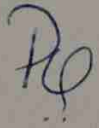
HANDLING

14. You will wish to invite the Secretary of State for Trade and Industry to introduce his paper. The Chancellor of the Exchequer will wish to comment. The Foreign and Commonwealth Secretary may wish to express a view on the political considerations. The Secretary of State for Northern Ireland may wish to comment on the importance of the project for employment in Northern Ireland.

CONCLUSIONS

15. You will wish the Sub-Committee to reach conclusions on the following:

- i. whether the opening offer on export credit for the conventional turbine "island" should match, in its terms and form, that offered by the French on the nuclear "island";
- ii. whether domestic support totalling £4.4 million should be made available to GEC, subject to the necessary approval within Northern Ireland;
- iii. what upper limit (inclusive of domestic support) should be placed on the total level of support for the project;
- iv. whether diplomatic pressure should be brought to bear on the French to discourage bidding-up of the export credit terms.


P L GREGSON

28 February 1984

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