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PRIME MINISTER

GUANGDONG NUCLEAR PROJECT

This minute reports developments since colleagues considered the project at EX in February, in view of the forthcoming Anglo-French summit on 29/30 November and your planned visit to China and Hong Kong in December. It proposes that we should use the Anglo-French summit to re-emphasise to the French the importance of standing together in the face of Chinese demands on financing.

2. In the course of negotiations, GEC's contract value estimated in March to be worth £322 million in current prices has come under pressure. Balance of plant items not directly associated with the nuclear or conventional island have been separated into a third package, to be procured with technical advice from the French electricity utility. Under pressure from Norman Tebbit the French have said they will try and retain UK involvement in this third package, but the outcome is uncertain. The Chinese have also pressed to maximise local manufacture. Together these pressures could reduce GEC's contract value by £50-£100 million.

3. In September, the French told us that they had decided to up-grade China from a category C to a category A country under their export credit premium system. Previously UK and French premia had been roughly comparable although ECGD categorised China as a B country under its own system. The French move created a large gap in French and UK premium charges, and increased Chinese pressure for a reduction in ECGD premium. I have now accepted a recommendation from ECGD's Advisory Council that China should be up-graded from Category B to Category A. Because of the very different criteria and methods of calculation of French and UK premium, this narrows but does not close the gap

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CEBT CCNO (2)
 Prime Minister
 For once the Treasury
 & DTI agree: you
 should urge President
 Mitterand at the summit
 not to get into a
 credit war over
 Guangdong. *CDP 23/4i*



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with the French. On the present financial offer UK premium would be reduced from about £35m to £28m, compared with French premium of about £19.5m, assuming for the purpose of comparison identical contracts. We shall have to consider carefully our tactics in employing the change to our best advantage. The Chinese may well still seek to close the gap completely. To meet this from public funds would, of course, add to the imputed subsidy. As a contingency, I have asked my officials to explore ways in which the private sector could be brought in, but our aim would be to hold firm at an A grading.

4. More generally, the timetable for negotiations has slipped continually throughout the year. Further commercial and technical negotiations have taken place, but there have not been any Government to Government negotiations on financing terms. In part, the slowness of the Chinese bureaucracy is to blame. But also, China Light and Power (CLP) deferred signature of the joint venture and electricity purchase arrangements until differences on the project with their major shareholder, Exxon, were resolved. CLP are now ready to sign, and progress should accelerate. But it is unrealistic to expect negotiations to be concluded before 15 January 1985, when the present French and UK financing offers will expire.

5. The project is formally excluded from consensus arrangements. There is thus no international constraint on the terms that can be offered, although we have attempted to impose a consensus framework on the terms of our offer. The French clearly attach great political importance to securing nuclear business in China: French officials have stated that whilst willing to co-ordinate a negotiating strategy with us, they will not in the end reject Chinese demands if this means the loss of the project. Political considerations may also have entered their decision to regrade China. The next test of French will is likely to be on 15 January, when we cannot be sure that they will agree to raise interest rates as much as we would like. This could cause difficulties in operating within the 25 per cent negotiating limit agreed at EX last February.



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6. Our dilemma is that if we want to stay in the project we are ultimately dependent on what the French are prepared to concede. They have already gone further on premium that we can match within ECGD's normal grading system. But time is moving on; the joint venture problem has been resolved and we are entering the final stretch. It would be difficult enough to withdraw now and will become progressively more so. That is not a course I recommend. However, in continuing to pursue the industrial, commercial and political benefits this project offers, we must do all we can to counteract the risk that the French may bid up stakes when it has become virtually impossible to leave the table.

Recommendation

7. At the Anglo-French summit we should therefore take every opportunity - including your discussions with President Mitterand - to underline the need for a realistic negotiating strategy to resist Chinese demands for undue concessions. In particular we should seek to secure French agreement that no financing concessions of any kind should be offered to the Chinese without prior Anglo-French consultation.

8. I hope colleagues will be prepared to support this line. If, despite our efforts, the French prove uncooperative or premium remains a sticking point, I may have to come back to colleagues again.

9. I am copying this minute to colleagues on EX, Peter Walker and to Sir Robert Armstrong.

J. Nutter

for

PAUL CHANNON

20 November 1984