



Foreign and Commonwealth Office

Mr Powell: to see

London SW1A 2AH

3 December, 1984

Dear Charles,

*(1) Await further letter
(2) Pl. copy personal & confidential to*

Gas Turbines for the Delhi Electric Supply Undertaking (DESU)

Thank you for your letter of 9 November about this subject. We have also seen Ruth Thompson's letter of 22 November.

*Sir R. Wald-
Gery,
New Delhi
com.*

Mr Raison is currently considering this question in consultation with Mr Channon and Mr Rees. We will ensure that the Prime Minister is informed of the outcome before any decision is taken. I understand that no decision is likely on this contract by the Indians until the formation of the new government in India after the elections on 24 December.

I enclose a copy of Mr Raison's letter of 27 November to Mr Channon which summarises the ODA analysis of this case.

I am copying this letter to Ruth Thompson (DTI) and John Gieve (HM Treasury).

Yr ever,

Peter Ricketts

(P F Ricketts)
Private Secretary

C D Powell Esq
10 Downing Street

27 November 1984

Rt Hon Paul Channon MP
Department of Trade & Industry
1 Victoria Street
LONDON SW1

INDIA: ATP FOR DESU GAS TURBINES

Thank you for your letter of 9 November enclosing a copy of the note which you had commissioned from British Electricity International (BEI). My officials had approached BEI at an early stage in the appraisal of this project and had followed their advice that the GEC would be in a better position to provide information. Since receiving your letter we have again been in touch with BEI - as suggested by your officials - in an attempt to secure further quantification of the factors relevant to the appraisal of the projects but BEI has not been able to provide it.

I hope it will not become common practice for DTI to commission a consultant in order to challenge the professional assessment of another Government Department about developmental merit. ODA, of course, have to observe strict procedures in the selection of consultants, and always prepare careful terms of reference. The BEI paper, not having been commissioned in this way, is of limited value: it does not focus on the economic aspects which are central to a developmental appraisal. I understand that in fact BEI were given no terms of reference at all, but merely asked over the telephone for their view of the importance of gas turbines to DESU. You will of course know that BEI are not disinterested as far as DESU is concerned, because they are in the market for a planning consultancy from DESU.

... I enclose an analysis which has been done by my officials of the BEI papers, which also takes account of subsequent discussions with BEI. The conclusion is that there is no basis for changing our initial view that the project cannot be justified in developmental terms. Indeed, further evidence has come to light which reinforces our doubts about the merits of the project.

Providing more electricity generation is not necessarily the solution to power shortages: adjusting tariffs might regulate demand, and spending money on reducing transmission losses and on getting maximum output from existing capacity might prove more efficient than providing new capacity. There is also no evidence that the benefits of reducing power cuts in Delhi will exceed the costs of running the gas turbines. We understand that substantial standby plant has already been installed - and will continue to be installed - by industrial consumers. Electricity generated by gas turbines will be $2\frac{1}{2}$ times

/the cost

the cost of thermally generated power yet the tariffs are such that they serve as an incentive to increase demand. Such a policy does not make any sense, least of all for a low income oil importing country whose development is increasingly inhibited by balance of payment constraints.

You referred in your letter to the further objection that the project is not cost effective, since it does not include financial provision for a waste heat recovery system, without which electricity will cost 20-25 per cent more. The fact that DESU have asked bidders to quote for this as an additional item provides no firm assurance on this point.

Even if the Indians have got themselves into a position where power cuts can only be avoided by an economically unjustified route, there is no reason why we should support them, even though they are determined to take it anyway. The whole burden of our approach and that of the World Bank and other donors has been to encourage sensible pricing and better use of capacity in this sector. My major concern is that for us to be associated with the present proposal will give the wrong signals about our future involvement in the power sector, where we want to focus on improving productivity, rehabilitation and economic pricing.

The recent evaluation of the ATP gas turbine project in Egypt justifies many of the foregoing conclusions. We would be open to serious criticism if we failed to learn the lessons of experience.

As you know it has been accepted that there has to be a developmental case in favour of any ATP proposal, and that proposals cannot be approved on a basis of commercial arguments only. In the present case I believe that it is particularly important not to appear to be bending the rules in favour of GEC. You will be aware of the criticism from members of the British and South Asian Trade Association about what they believe to be the disproportionate share of aid to India that is directed towards GEC and the unfavourable comments in the press.

I realise that you are exposed to considerable pressure of lobbying from GEC. However I do not think that GEC has any cause for complaint about the extent to which its business has been assisted from our aid programme to India. GEC are the main contractors for the recently agreed BALCO power station, which at £131 million receives the biggest project aid allocation ever made, and sub-contractors for the turbines for Rihand power station, which is receiving £110 million aid. Moreover, I have already agreed to an offer of £7 million ATP to support a GEC bid for the £45 million Vindhyachal high voltage transmission project, and I understand that DTI are considering a further ATP proposal for GEC digital microwave transmission equipment for India likely to be worth £41 million. DTI are also encouraging ODA to make a bilateral aid allocation of £12.5 million for a GEC contract for the Nagarjunasagar hydro electric station, and £5 million for GEC diesel electric locomotives.

I am doubtful about the argument that, if GEC gain this contract, it will help them to conclude a joint venture agreement with BHEL. The Indians can be relied upon to seek the best deal, and it is highly unlikely that BHEL's judgement of GEC as a suitable partner will be affected by the latter's ability to win a contract secured purely on the basis of aid financing. We understand that the BHEL joint venture will not involve the same size of turbine, and that they are interested in units of 6mw or less, which would involve an entirely separate part of GEC. In any case, GEC themselves have reported that the short list of potential BHEL collaborators includes only one of GEC's competitors for DESU, namely General Electric, who have entered an underspecified and relatively expensive bid which would appear to place them out of contention.

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However, it is not my purpose to pass judgement on the commercial aspects. But ODA does have a responsibility to determine whether there is a developmental case. I do not believe that we have been able to justify the project in developmental terms. In the circumstances I hope that you will agree that there is no point in pursuing the matter further.

In view of the concern expressed by Treasury officials over this proposal, I am sending a copy of this letter and yours to Peter Rees at the Treasury.

for TIMOTHY RAISON
(Approved by Mr Raison
and signed in his absence)

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