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Treasury Chambers, Parliament Street, SW1P 3AG

PO 14/1 +

The Rt Hon Paul Channon MP
 Secretary of State for Trade and Industry
 Department of Trade and Industry
 1 - 19 Victoria Street
 London
 SW1H 0ET

14TH April 1987

Dear Paul,

DTI/ECGD SUPPORT FOR JOHN BROWN CONTRACT: USSR

Thank you for your letter of 3 April ^{at flap} setting out the concessions agreed for DTI and ECGD support to John Brown in order that they could compete for the polypropylene contract in the USSR. I am delighted that John Brown were successful in securing the contract.

In discussing the concessions which were to be offered to John Brown, we both accepted the need to ensure that they should be ring-fenced to the maximum possible. I acknowledge the efforts you have made on this score, although I remain very concerned about the possible repercussions of the precedents we have set. I also agree that we should encourage the Russians to consider credit financing in low interest rate currencies. I hope that you will be able to encourage companies trading with Russia to press this as in their own, as well as our, interests.

I agree with the conditions you propose for ring-fencing the reductions in the ECGD risk premium and the TTC premium. The 30 per cent reduction in the risk premium should be extended to Courtaulds Davy and Simon Carves only if the contracts are financed in US dollars or ECU and the conditions in your sub-paragraph (b) are fully met. This concession will, in accordance with the terms of that paragraph, relate to contracts which those three companies sign before 3 July. I also agree that in order to qualify for an overall reduction in the TTC premium it would be reasonable to extend the concession only to contracts signed before the end of last week.

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My officials have discussed further with yours the way in which the reduction in the ECGD premium should be reflected in the Trading Account, against the background of our shared objective of ring-fencing this concession and of ensuring that the arrangements are properly accounted for and accurately reflect what has been done. In the light of these discussions, I am reluctantly prepared on this occasion to acquiesce in your proposal that the Trading Account should be credited both with the amount of ECGD's premium received from the exporter and with an amount notionally diverted from savings in the public expenditure provision. Given the need to reconcile the Trading Account with the Vote Account, there will need to be an adequate note in the accounts explaining the decision taken. This note will need to be agreed with my officials.

However, I continue to find this an unsatisfactory way of accounting for the transactions involved and I hope we can agree not to adopt it on future occasions. What was just about acceptable on a one-off basis i.e. for Guangdong is increasingly unacceptable with extended use. We now have a position where ECGD's Trading Account is being credited with funds which do not accrue as a result of their trading operations but as a result of Ministers' decisions to provide a covert subsidy from public funds. If this course was to be proposed again (and I hope not), I believe it is important that you seek proper Parliamentary authority. In other words further proposals would have to come to Ministers either as a clear decision to set aside ECGD's Trading Account objectives or as a decision to seek Parliamentary authority for expenditure from Votes to subsidise the Trading Account.

I am copying this letter to members of E(A) and to Sir Robert Armstrong.

Yours,
JH

JOHN MacGREGOR





Secretary of State for Trade and Industry

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3 April 1987

The Rt Hon John MacGregor OBE MP
Chief Secretary to the Treasury
HM Treasury
Parliament Street
LONDON
SW1P 3AG

CDP
3/4

Dear John.

DTI/ECGD SUPPORT FOR JOHN BROWN CONTRACT : USSR

This is to confirm our agreement on DTI/ECGD support to John Brown for the polypropylene contract they are negotiating in the USSR in the light of telegrams from Moscow urging further HMG help. In view of the Prime Minister's on the spot assessment we agreed that the concessions requested in Moscow telegram 065 might be made exceptionally to help John Brown reduce their contract price in order to take this opportunity of securing an important contract in the USSR. I am pleased to report that we have heard that they have indeed won this contract.

We also agreed that it would be important to ring-fence these concessions as much as possible and I set out my decisions below. However, I also consider that it is important that, with our eye to future trade possibilities, we should encourage the Soviet side to consider UK credits financed in currencies other than Sterling. I am pleased therefore that the Russians have opted for US dollar financing, which should also reduce our future subsidy bill.

Following our conversation the following concessions were offered to John Brown subject to the conditions described.

(a) DTI technology development grant

The Department has offered support of up to \$1 million under the Science and Technology Act as a contribution towards John Brown's

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costs on 13 possible areas of research and technology development associated with this project. This offer is subject to the company satisfying the Department that the proposed eligible costs required to generate support of \$1 million comply with the innovation criteria and that this support is deducted from the company's price.

(b) Reduction in ECGD buyer credit premium

It was agreed to offer John Brown the same (30 per cent) reduction in ECGD risk premium for a US dollar financing operation as had been offered for an ECU deal and on the same conditions. i.e:

- (i) the contract has to be signed within 3 months;
- (ii) the exporter has to make a price cut of at least double the amount of ECGD premium reduction; and
- (iii) he has to agree that our accountants may inspect his books to ensure against excess profits and to treat this concession as confidential.

Our preliminary estimates of the cost of interest makeup for a US dollar deal suggests that the saving would be of the same order or slightly more than for ECUs. We will let your officials have the final calculations here. The total amount of the premium reduction is estimated at \$1.2m and we envisage that this concession would also be extended to the three other firms (Courtauld, Davy and Simon Carves) to whom the ECU concession was offered on the above terms, but only if it is requested by the companies concerned.

(c) Concessions on ECGD Tender to Contract (TTC) Scheme

We agreed that we would allow concessions here to the amount requested by John Brown (i.e \$1,114,000) but in order to ring-fence them more effectively I agreed that this should be done by means of a special reduction in the TTC premium rather than in the form requested by John Brown which would set a precedent less easy to defend. In particular I consider that it would be unwise to agree to waive the normal 1 per cent first loss requirement which is an essential feature of the TTC Scheme. However we could agree to accept for TTC purposes that the signature of a document falling short of a final contract, but nevertheless representing an irrevocable commitment binding us on both sides, would suffice to enable them to sell dollars forward and thus curtail their exchange fluctuation risk. Thus the horizon of risk is shorter than usual, and as the award of the contract was made during the Prime



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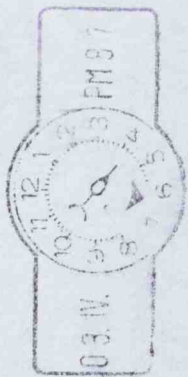
Minister's visit the risks of the Soviet buyer reneging on the deal subsequently have also been reduced. In my view these special factors justified the premium concession that we have offered and this combination of circumstances is less likely to occur in future. There is only one other case where this question may arise. We have just learned that Davy will be putting in their final bid for the £400m polyester fibre plant on Monday and it is probable that they will seek a similar concession for Deutsche mark or Dollar finance. As a contract awarded next week would also be attributed to the Prime Minister's visit, I consider that we would have to concede this if requested by Davy.

There is one matter which has still to be settled: this concerns the accounting treatment which will be applied to the reduction in ECGD Buyer Credit premium if the business is won. I hope that this question can be settled at official level, my own views are set out in the letter my Private Office sent to your's yesterday. I would be most disturbed at the precedent if the ECGD Trading Account were to be penalized by our decisions. I will of course discuss again with you if necessary.

I am copying this letter to members of E(A), Alan Clark and Sir Robert Armstrong.

PAUL CHANNON

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~~Mr POWELL~~ NO 10 DST

Mr SEYMOUR DTI

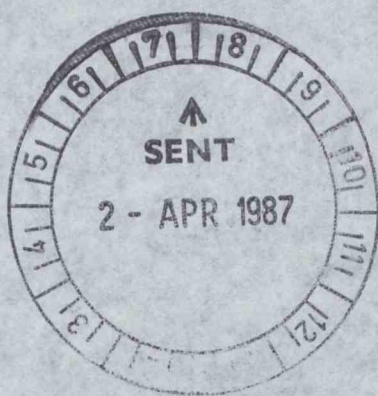
Mr LONGRIGG SOVD

FOR POWELL, NO. 10 FROM CHASE

DTI FOR SEYMOUR

FCO FOR LONGRIGG, SOVIET DEPT

JOHN BROWN POLYESTER PLANT



1. YUSHKIN, GENERAL DIRECTOR, TECHMASHIMPORT, WILL BE INFORMING JAPANESE AND ITALIAN COMPETITORS THAT JOHN BROWN HAVE WON CONTRACT AT 1600 HRS MOSCOW TIME TODAY. HE IS ANXIOUS THAT FINAL PRICE OF PROJECT SHOULD NOT BE MENTIONED, AS IN SPECIAL CIRCUMSTANCES OF PRIME MINISTER'S VISIT HE ACCEPTED JOHN BROWN'S BID WHICH WAS HIGHER THAN COMPETITION.
2. WE THEREFORE AGREED THAT THE CONTRACT SHOULD BE ANNOUNCED AS PART OF A PACKAGE AND THAT THE EMBARGO WOULD BE LIFTED AT 1300 HRS LONDON TIME. HE WAS CONTENT THAT THE PROJECT MIGHT BE INCLUDED IN AN ANNOUNCEMENT ON THE FOLLOWING LINES: "DURING THE PERIOD OF THE PRIME MINISTER'S VISIT, CONTRACTS AND A LETTER OF INTENT TO A TOTAL VALUE OF POUNDS 403 MILLION WERE CONCLUDED. THESE INCLUDED THE MAJOR JOHN BROWN CONTRACT TO BUILD A POLYPROPYLENE PLANT AT BUDYONNOVSK, THE GEC SIMON CARVES PROJECT TO BUILD A LOGIC PROCESS CONTROLLER PRODUCTION PLANT AT YEREVAN, THE REFURBISHMENT OF 3 TEXTILE PLANTS BY TAYLOR WOODROW AND ANOTHER BY RIETER SCRAGG."

CARTLEDGE

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