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FCS/86/186

CHIEF SECRETARY TO THE TREASURY

Peugeot Talbot and Iran

1. I have seen correspondence on this subject between you and Paul Channon, resting with your letter of 30 June. *at trap*

2. I appreciate the good prudential reasons why it was agreed last year that ECGD should move away from pre-shipment cover for this contract, and your concern that the existing reduced level of such cover should not be extended indefinitely. In the short-term the Iranian economy is indeed facing considerable difficulties, and foreign exchange is being severely rationed, with food, medicine and war supplies taking precedence over other industrial imports. We cannot therefore be very sanguine about the opening of letters of credit for Talbot before, say, the end of this year when their foreign exchange income, and the calls on it, for their 1986/87 financial year may be clearer.

3. Nevertheless, I must support the arguments in Paul Channon's letter of 23 May. In the short-term, it has to be recognised that the Iranians are very cautious in their policy of issuing letters of credit, which, I believe, they invariably honour. They have so far not run up any substantial foreign debt, paying for imports on essentially a cash basis. As they continually point out to us, their record and creditworthiness is probably

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better than many countries - including Iraq - to whom we continue to provide considerable ECGD cover. In the longer term, it is our firm policy to ensure we maintain, and if possible improve, our political and commercial position in this large and important country. The two are inextricably linked. The Talbot contract remains our largest export contract with Iran and has played a significant part in our maintaining our market share during an economic downturn. Should the withdrawal of ECGD pre-shipment cover be - or be presented as - responsible for the contract ending, this would, I am sure, severely damage not only Talbot's chances of landing the contract for an eventual replacement for the Peykan, but also wider British trading interests, to an extent which is unfortunately not quantifiable.

4. It would also, I fear, damage our political interests. The Iranians are prickly customers, and quick to see slight in any adverse action by us. I would be reluctant to provide those in Iran who continue to be highly critical of Britain with additional ammunition, at a time when there are indications that others in the regime may be prepared to work towards a more constructive relationship with us.

5. On balance, therefore, I believe that we should be prepared to extend cover in the belief that this is in our long-term interests, and that the Iranians do value this contract and will honour it by issuing letters of credit once their foreign exchange position is clearer. I suggest that we agree to Paul Channon's suggestion of extending the cover until the end of the year, and review the position in December.

(GEOFFREY HOWE)