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Dear John,

EUROPEAN TRANSONIC WIND TUNNEL (ETW)

I have seen your letter of 28 January to George Younger and have since received John Fairclough's letter of 2 February.

The concerns you express are precisely those which I had when I first heard of this project. I was not persuaded that there was a sufficiently strong industrial case for proceeding, particularly given the pressure which I faced elsewhere on my budget. Having reconsidered the UK position, however, I feel that we have now progressed so far with the project and given such firm indications of our continuing support to our other partners that it would be extremely difficult to pull out now. I have of course noted your point about the strict interpretation of the MOU but I do not frankly think we could now fall back on this. If you or John Fairclough seriously want to re-open the case then I would not wish to stand in your way although I have to say that I endorse Geoffrey Howe's view that we are now much too far down the track.

Turning to your detailed comments, I think we must be careful not to treat the increased costs to the UK purely as an overrun as your letter implies. There are three factors which account for the increase: cost escalation due to detailed project definition and design; the deficit financing arrangements; and exchange rate variations.

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On the first, construction costs have increased from DM460m at January 1984 ec to DM562m at January 1987 ec, of which the UK will pay 28%. This represents a maximum price, to be written into the MOU, and includes an adequate contingency. Allowing for the change in economic conditions, this implies a cost increase of approximately 16% as a result of a detailed project definition and design phase. For a high technology project, this is not unusual.

The deficit financing arrangements had not been agreed at the time of signing the MOU for phase 2.2. The solution finally achieved, at the insistence of the UK, and with Treasury approval, was for the full funding of the three year initial operation period, after which all support would cease and the company would have to be self-financing. This will clearly reduce the cost to the UK over the lifetime of the project and is therefore to be welcomed but the cost that has now been identified was not taken into account before. This cost stands at DM109m; the UK share will be 31%. Thus the total cost to the UK of construction and initial operation is now DM191.2m as opposed to the earlier cost of DM128.8m for construction only.

The third, and most significant, factor in the cost increase is one over which neither MOD nor DTI has any control, namely the change in the £/DM exchange rate from approximately 4 to 3.

You ask for a restatement of the benefits of the project to the UK. As you know, the project was of course completely reviewed in 1985, and in September 1987 a jointly agreed supporting paper was prepared by the MOD and DTI representatives on the ETW steering committee with the help of technical specialists from the Royal Aircraft Establishment (RAE). The industrial benefits were noted in the summary: the beneficiaries of the proposed wind tunnel would be the UK aircraft industry together with its European counterparts, who would be enabled to remain in a competitive position against US industry who would have access to their own National Transonic Facility. It is now clear that if ETW went ahead without UK participation, British companies would be denied access to the facility. This would almost certainly result in British Aerospace losing the battle for Airbus wing design to a very strong German challenge. For the foreseeable future British Aerospace would be relegated to the position of a parts supplier to Airbus, having lost pre-eminence in a prestige area.

John Fairclough's point about simulation techniques was also addressed in the 1987 paper. The conclusion was that the use of ETW by European industry and defence agencies will reduce the risk of performance shortfalls and allow improvements in

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aerodynamic design to be achieved through the ability to test at near to flight conditions. Advanced methods of computational fluid mechanics will improve aerodynamic design and reduce the need for development testing in wind tunnels, but the final pre-prototype checks on air vehicle performance, stability and control, and air loadings require the use of ETW. The forecast utilisation of ETW takes full account of the increasing role of CFM in aerodynamic design.

You also raise in your letter the question of the contribution that we might expect from UK industry. This topic was the subject of exhaustive review in 1985. Previously, British Aerospace had offered to contribute up to £3m of the UK share on the condition that French and German industries did likewise. When it became apparent that, due to the attitudes of the French and German governments this condition would not be met, the then Secretary of State for Trade and Industry, Norman Tebbit, with the written approval of Peter Rees in the Treasury, relieved British Aerospace of this obligation. Thus I do not believe there is anything to be gained by reopening the argument.

On a more general point, John Fairclough comments that we also need to bear in mind the wider implications for our international R&D priorities and how the ETW fits in with other collaborative projects. As he will have seen from my letter of 31 January to Geoffrey Howe, I strongly endorse this view and would be interested in any suggestions he may have for how the present arrangements might be improved.

I hope you are now satisfied on these points and that we shall be able to move forward quickly to announce full UK participation in this [redacted] European project.

I am copying this letter to the Prime Minister, Sir Geoffrey Howe, George Younger, John Fairclough and Sir Robin Butler.

Yours ever,

Ken

KENNETH CLARKE

P.S. The fact is that the Germans believe that the Prime Minister gave a firm assurance to Chancellor Kohl in 1985 and there is little point in re-opening it at all now.

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