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FROM: CHIEF SECRETARY
DATE: 29 February 1988

Prime Minister

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EUROPEAN TRANSONIC WIND TUNNEL

Charles Powell's letter to DTI of 13 February said that Chancellor Kohl's officials had raised with him at the EC summit in Brussels the question of UK participation in this project. I think we have now gone as far as we can in inter-departmental discussions, and I would be grateful for your views.

2. ETW is a collaborative project with Germany, France and the Netherlands; our share is 28%. The tunnel is to test the aerodynamics of aircraft and it will be located in Cologne. We have participated in the preliminary phases, and are now faced with a decision as to whether we should participate in phase 3, the construction of the tunnel.

3. When we decided in 1985 to go ahead with the Final Design Phase the expected UK share was £33 million. Because of cost escalation, exchange rate changes, and the inclusion of previously excluded costs, our share has approximately doubled to £63.8 million. Reluctantly, Kenneth Clarke and George Younger are prepared to fund this equally between them. However, given the substantially increased costs, and the fact that we will be embarking on the most expensive phase with risks of further cost overruns and no provision for withdrawal except at very high cost, I thought it right to call for a re-evaluation of the expected benefits. You may have seen Kenneth Clarke's response to me of 22 February. George Younger's earlier letter of 19 January suggested

In view of your earlier commitment to Chancellor Kohl, I fear there is no real option but to go ahead with this.

MODE

DTI

have to re-evaluate funds.

There will be a

major

Anglo-

German

row if we do not.

Agree?

CD

2/3

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that there was no foreseeable defence interest in the project (although it began life under NATO auspices). The project will be of some benefit to British Aerospace in relation to Airbus, but BAe is already receiving £450m launch aid for Airbus A330/A340 development costs. It may also have benefits over its 30 year life for the military as well as civil aerospace industry. But I think it is fair to conclude that these benefits are not so great as in themselves to justify going ahead with the project. It is the kind of near market support from which, under DTI's new enterprise policy we are withdrawing. But I reluctantly accept that, at this stage, there is no scope for seeking an industrial contribution.

4. There is no doubt that Chancellor Kohl would be very disappointed by a UK decision now to withdraw. In 1985, he personally enlisted your support for the project, and I attach for easy reference your message to him. Following your message, we signed the Memorandum of Understanding for the final design phase.

5. It is of course sound practice in large capital projects, whether collaborative or national, that they proceed by clearly defined stages, and commitment to one stage does not carry commitment to carry on regardless. Consequently, while the final design phase MOU indicated that the partners had a "firm intention" to proceed to the construction phase, it was made clear in that MOU that that phase would be the subject of a separate agreement. In these circumstances, it would clearly be unreasonable for the Germans to interpret your 1985 letter as a commitment to carry on to completion, whatever the costs. They will naturally be disappointed, but could hardly accuse us of bad faith.

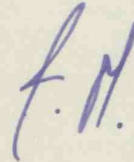
6. Nonetheless, there are wider political considerations, and given Chancellor Kohl's personal commitment you will want to decide whether to aggravate relations by the UK refusing to participate further.

7. If you should decide that we should go ahead, I hope

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that George Younger as the shareholder in the International Company will do everything possible to ensure that costs do not escalate further. I shall look to him to set out how he proposes to do this. We shall also wish in future to make better use of existing mechanisms for processing proposals for civil and defence R&D as John Fairclough has suggested.

8. I am copying this letter to Geoffrey Howe, George Younger, Kenneth Clarke, John Fairclough and Sir Robin Butler.

A handwritten signature in blue ink, appearing to be 'J.M.', is located to the right of the typed name.

JOHN MAJOR

AEROSPACE: Airbus
A3

