



MINISTER OF STATE FOR DEFENCE

D/MIN/TT/3/12

Prime Minister

FRIGATES FOR PORTUGAL

Prime Minister
Lord Frenchard does not seem to be
wishing you to intervene & I do not
imagine that you would wish to do so.
May I say that you "have taken note".

John Nott has asked me to write to you about a problem with assistance to the Portuguese in obtaining some anti-submarine warfare frigates, where there is a real danger that Rolls Royce and other United Kingdom firms will lose some £20m of business because we are unable to provide more Government assistance.

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2. As you may be aware, NATO wants Portugal to obtain three of these frigates so that she can fulfil part of her role in Alliance defence. Portugal is too poor to buy the ships herself, and NATO nations have therefore been asked to contribute towards the scheme. The frigate design preferred by the Portuguese Navy is the Dutch Kortenaer, with Rolls Royce engines, at an estimated cost of £400m at September 1978 prices.

3. There are now strong indications that the Portuguese will turn from this initial preference to German frigates, with US General Electric engines, because of the considerable financial inducements offered by the Governments and industries of these two countries. Germany has said that all of its military aid to Portugal (about £15m a year) can be applied to this project over the next eight years; the US Government position is less clear, but General Electric have offered very favourable terms for their engines, which could go into either the German or the Dutch frigates.

4. Rolls Royce are naturally very concerned at the danger of losing this business, and their Chairman has written to John Nott appealing for further Government assistance to the Portuguese to encourage them to buy the Kortenaer with Rolls Royce engines. The firm have on their own initiative already offered one set of propulsion equipment free of charge, but a UK Government contribution of £11m (the 1981 cost of two more engine sets) is seen as necessary to stand a chance of swinging the deal.

5. Here, unfortunately, is the difficulty, for in the present circumstances there are no funds available. Last August, with Cabinet Office involvement, Ministers decided

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15 there no help available for D.O.I.?
(My letter of 19 March)

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that our contribution must be limited to commercial credit for the purchase of British equipment. The Foreign and Commonwealth Office and the Ministry of Defence had no funds available, and Keith Joseph wrote that, despite concern for Rolls Royce marine engine business, the Department of Industry could not help for there were no means available under any of the existing schemes of assistance to industry.

6. Following Rolls Royce's most recent approaches - and some from the Netherlands Embassy - the possibilities have been reviewed, but essentially the position remains unchanged. The Defence budget is strained to the limit, and in answer to my query, Neil Marten has said there is no justification for breaching successive Governments' undertaking that overseas aid funds will not be used for military aid purposes. This, despite it becoming both German and US policy to apply aid in this way. Military or civil offset arrangements with the Netherlands look to be a non-starter - there is nothing of sufficient importance in the pipeline - and ECGD have advised that their newly introduced "credit-mixte" scheme cannot be used in this case.

7. Given this situation I am afraid we can offer no more for Rolls Royce comfort. But this is a sorry answer for UK industry generally for if the Portuguese turn to German frigates, other UK firms will almost certainly lose orders for equipment for the frigates worth up to \$15m. Rolls Royce, as well as losing the business for the three frigate engines, will see General Electric secure a foothold in the European market and probably go on to take away other business from the UK firm.

8. In conclusion, we are likely to face some critical comment if UK industry lose this business which Rolls Royce believe could be saved by Government assistance. Whether in fact such assistance would affect the issue at this eleventh hour - the Portuguese are expected to decide in the next few weeks - is open to question. But all the

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possibilities for assistance have been re-examined and have been found to be impracticable.

9. I am sending copies of this minute to members of EX and to Sir Robert Armstrong.

17 March 1981

Yours
Tom Hunt

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