



MO 11/14

FOREIGN AND COMMONWEALTH SECRETARYCHINA - PROJECT 051

China
 (2)
 K. Smith
 Prime Minister
 It is perhaps surprising that this case has not been brought up sooner.

Negotiations have been taking place, as you will know, with the Chinese for the modernisation of two LUDA class destroyers. The negotiations have in fact taken rather longer than expected and the scope of the project (called Project 051) has contracted slightly from what was originally envisaged. Nevertheless it could still be worth between £100M and £200M. It now looks as though the negotiations are nearing completion, and we have been told that, for financial reasons the Chinese will wish to sign a contract by the end of this year.

2. The question of clearing the deal with our COCOM partners arose in correspondence last year and you agreed that we should defer this until negotiations were more advanced. Since then, we have agreed a "China differential" with our COCOM partners and, consequently, we are now under an obligation to put the case formally to COCOM. I understand that your officials are making arrangements for this to be done as a matter of urgency and that they have also given advance warning of the case to our major COCOM partners.

3. We could well find ourselves under some pressure to give early approval to British Shipbuilders and British Aerospace to proceed. Certain details of the contract - in particular the financial arrangements - are still not finally settled, and indeed it is possible that the whole deal could founder, but we have received reliable evidence that the Chinese have allocated funds for the project in next year's budget. If that is so, it is a powerful incentive for them



to reach an early decision on the deal, since, under the Chinese system, the funds will be withdrawn if they have not been committed by the end of this calendar year.

4. Our Ambassador in Peking has therefore urged strongly that, although we cannot be sure that the Chinese will be ready to sign by the end of the year, we should ensure that we should be in a position to give British Shipbuilders the necessary Government approval at short notice. The Ambassador has argued that we will jeopardise the contract if we cause delay at this stage.

5. It is for this reason that we are putting the case urgently to COCOM. However, we can expect severe difficulties with some of our partners, and particularly the United States. The current dispute we are having with them over their refusal to grant re-export licences for certain minor US components in equipment which Thorn-EMI have contracted to supply to China has indicated the extent of US sensitivity on China cases. Project 051 is considerably more sensitive in military terms than the Thorn EMI case. It also contains a substantial number of US components, so the US has ample opportunity to make difficulties. We are therefore offering to discuss the case with American officials in Washington as a matter of urgency in order to counter the objections we expect them to raise.

6. There are likely, therefore, to be considerable problems ahead, and it is seeming increasingly unlikely that we shall be able to clear the project through COCOM before the end of the year, if indeed we can clear it at all. If COCOM does not clear the project, the consequences would be severe. British Shipbuilders and British Aerospace have invested much time and effort in the negotiations with



the Chinese and we may expect a very forceful reaction from them if we have to veto the project at this late stage because we cannot obtain COCOM agreement. The effects of a COCOM rejection in our relations with the Chinese will be severe and it would certainly put an end to any further equipment sales, since the Chinese regard this case as a test of our developing defence sales relationship.

7. On the other hand, if we were to override a COCOM objection, particularly if it stemmed from the US, we would put a severe strain on our relations with our COCOM partners. Such action would in any case, be only partially worthwhile, since the US could still disrupt the deal by refusing permission for the re-export of crucial components.

8. Until we have a reaction from our COCOM partners it is difficult to know how much of a problem this is going to be. However, I thought you should be aware at this stage of the likely difficulties ahead. In particular, you will wish to be aware of the possibility of a prolonged and possibly acrimonious dispute with the US which may have to be resolved at the highest political level. In my view we must be prepared to face up to this since this is a case we cannot afford to lose.

9. I am copying this minute to the Prime Minister, to the other members of OD, to the Secretary of State for Industry and to Sir Robert Armstrong.

JW

Ministry of Defence
20th November 1981

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Secretary of State for Industry

7 December 1981

China
Prime Minister

The Rt Hon The Lord Carrington KCMG MC
Secretary of State for
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Downing Street
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ASL 8/12

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*r.a.
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Dear Peter,

CHINA PROJECT 051

I have seen John Nott's minute to you of 20 November about the COCOM and other problems we might face in this case, and I agree with what he says.

2 I cannot stress too highly the importance and value of this contract to UK industry, particularly in view of the effects of the Defence White Paper on our naval shipbuilding plans. If we are successful it could also lead to similarly valuable refit work on the remaining Chinese LUDA warships. I agree with him that we must make every effort to avoid losing this contract.

3 I am copying this to John Nott and the other recipients of his minute.

*Yours
Peter*

8 DEC 1981

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