

For E(A) a Wednesday AT 16/7

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Prime Minister

This will be on the agenda for E(A) on Wednesday. No action required at present

AT 13/7

Prime Minister

1. You have received Garret FitzGerald's letter of 10 July in which he asks whether the Government is prepared to proceed with the project on the basis of the Understanding agreed in October 1983. Receipt of Dr FitzGerald's letter does not change the options open to us which are -

- (a) to accept the terms and conditions now on offer and sign the contract because it is politically too late and too dangerous for Anglo-Irish relations to let the project fall; (Dr FitzGerald's case)
- (b) to accept that the project is so far from viability in the circumstances which now face us, particularly as to purchase price, that we should seek an orderly withdrawal from our commitment without an attempt to negotiate concessions which would still leave us with a project unable to meet the conventional tests; or
- (c) in line with the proposals made in my letter to colleagues of 22 June and the acceptance by you that we should seek to re-negotiate, we should urge the Republic to discuss with us a major concession on price.

2. Dr FitzGerald gives no indication that his government is willing to make concessions on the purchase price of gas and indeed his final paragraph is seeking to establish whether we are prepared to go forward without re-negotiation. I still feel that this is not an option which is tenable for reasons which are spelled out in the draft reply. Dr FitzGerald's final

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question leaves it open to us to accept the implication of his letter that no price abatement is likely and to begin the formal withdrawal process at this stage. I assume, however, that you will be reluctant to authorise this drastic step without further collective discussion.

If however we are to pursue course (c), I think we must first form a clear and collective judgement as to whether any concession the Irish are likely to contemplate could bring the project within the bounds of acceptability, having regard to its wider political significance. The Chief Secretary clearly thinks not, and although I believe his reaction to the note of Adam Butler's meeting with Mr Spring did not do justice to the skill with which Adam played a most difficult part, I do not believe it would be in our interest, in replying to the Taoiseach, to float the idea of a compromise unless and until we have decided that we could live with the result (and there is no present ground for believing that the Irish would be prepared to contemplate a price concession of 4 or 5 pence per therm).

Indeed, until we have reached a collective view on the extent to which we are willing to renegotiate, I do not think that any useful reply can be sent to Dr FitzGerald. Any holding reply would run the risk of allowing him to think that we might be willing to do as he says, and to proceed on the basis of the October 1983 understanding.

I am acutely conscious of the time constraints upon the project. If we are to have any hope of bringing natural gas into Belfast by the autumn of next year (which was our original intention) we cannot contemplate delaying the decision beyond early August at the latest. To miss this date will not only set back the programme by a year, but will also effectively destroy the public

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confidence and the consumer base upon which the new industry
is to be built.

I hope therefore that we can meet urgently to discuss the approach
we should take; if we decide to follow course (c), you could then
reply to Dr FitzGerald on the lines of the attached draft.

I am sending copies of this minute (with a copy of Dr FitzGerald's
letter to you) to our EA colleagues, Sir Geoffrey Howe and to
Sir Robert Armstrong.



JP

13 July 1984

DRAFT LETTER

FILE NUMBER.....

ADDRESSEE'S REFERENCE.....

<p>To</p> <p>Dr FitzGerald</p> <p>(Full Postal Address)</p>	<p>Enclosures</p>	<p>Copies to be sent to</p> <p>(Full Address, if Necessary)</p>
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LETTER DRAFTED FOR SIGNATURE BY PRIME MINISTER
(Name of Signatory)

Thank you for your letter of 10 July. I do appreciate your concern about the proposals for the supply of natural gas to Northern Ireland. We found it very distressing that Adam Butler had to tell Mr Spring of the difficulties which had become clear so late in the day.

While the deteriorating market situation has a major impact upon the project, the price of gas to Northern Ireland as determined by the formula in the Memorandum of Understanding is already very significantly above anything which was foreseen last year - and all our advice is that this is not simply a short-term aberration in the market but a trend that is likely to continue. The competitive position of gas against coal in the Northern Ireland market is being seriously and continuously eroded.

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It is true that the major changes in the demand forecasts relate to the latter part of the project but it is precisely in that period that the project was to earn significant surpluses to balance the heavy losses in its early years. Indeed, to help the project meet the test of financial viability, we have been prepared to evaluate it over a period well beyond the 22 years of the intended gas supply contract - thus taking on trust our ability to contract further supplies on reasonable terms. On any reasonable assessment, the latest projections of market and gas price would not allow the project to be viable even on such generous treatment. Indeed on present perceptions it could have a serious negative impact upon the Northern Ireland public expenditure provision over the total period.

Like you I am extremely unhappy faced with the prospect that the Memorandum of Understanding might not be capable of being developed into the mutually beneficial project which we all believed to be within sight at that time. We were careful always (on both sides) to point to our intention that the supply of natural gas from Kinsale to Northern Ireland would be undertaken as a sound economic project which was financially viable in its own right. We made clear that it was not being undertaken for political reasons and on that basis it demonstrated the value of co-operation in appropriate economic areas. There is no doubt that if we were to go forward on a basis which could be easily shown to be non-economic for Northern Ireland the credibility of further economic co-operation between the two governments in relation to Northern Ireland would be seriously undermined.

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The changes which Adam Butler explained to Mr Spring therefore pose a real dilemma. The economic justification for the gas project has been transformed into an economic burden. It would be irresponsible to continue with the project as it stood in the October 1983 understanding. But the project has the same high political importance for the United Kingdom as it does for the Republic of Ireland, and it was in recognition of this, and in the hope that it might still be possible, by major moves on both sides, to save the project from cancellation, that Adam Butler asked Mr Spring whether your Government would be willing to make such a move. I appreciate that the difficulties for you are great, but we would not have broached the matter with your Government if the difficulties for us were not so great as to compel us to face the prospect of cancellation. Because of the wider importance of the project we are ready, if you are, to take on a major extra burden in financing it; I hope very much that you will be able to say the same.

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