

PO-CH/NL/0187

PART C

CWEX  
LAWSON

PART C

**SECRET**

(Circulate under cover and  
notify REGISTRY of movement)



PO -CH /NL/0187



PART C

DD: 25 years

6/9/95

Begin: 20/4/88

Ends: 18/5/88 (CONTINUED)

CHANCELLOR'S 1988 PAPERS  
ON THE SHIPBUILDING  
INDUSTRY

PO -CH /NL/0187

PO -CH

PART C

SECRET

FROM: MRS M E BROWN

DATE: 20 April 1988

CHANCELLOR

*Mr Clarke has confirmed X.*

cc: Chief Secretary  
Financial Secretary  
Sir Peter Middleton  
Mr Anson  
Mr Monck  
Mr Burgner  
Mr Moore (o.r.)  
Mr White  
Mr Guy  
Mr Rutnam  
Mr Call

**BRITISH SHIPBUILDERS**

It would be helpful if you or the Chief Secretary could raise the following point with Mr Clarke in the margins of Cabinet tomorrow. It concerns the negotiations for Govan.

2 The Prime Minister's meeting on 31 March agreed that in the last resort continued Intervention Fund support for Govan was not ruled out. If possible a settlement with Kvaerner should be based on a once-for-all dowry of up to £75 million. But if continued support did have to be granted, the dowry - if any - should be reduced to a minimum.

3 We are concerned that DTI officials may get themselves into a negotiating position where they are committed to a dowry, and Kvaerner then insist on continuing support too.

DTI say that Kvaerner have made it clear in their letter of intent that they will negotiate on the basis of a dowry - but despite our request, DTI have not yet copied us the

SECRET

letter. They further assure us that Kvaerner understand that a dowry means no Intervention Fund - but there seems to be nothing in writing from Kvaerner on this.

4 It would be very useful if you could:

- ask Mr Clarke for an assurance that there is no question of agreeing Intervention Fund support as well as a dowry; | X
- emphasise that if Kvaerner do seek intervention Fund Support, then all bets are off on the dowry;
- remind him that Treasury officials (on your authority) wrote to him on 11 April to say that if Kvaerner did seek continuing support there must be a break in the negotiations, to give Ministers time to assess precisely what should be offered, and the implications for other yards such as Harlands.

Mary Brown

MRS M E BROWN

*pp3-11*

FROM: A M WHITE  
DATE: 20 APRIL 1988

**CHANCELLOR**

cc Chief Secretary  
Financial Secretary  
Sir P Middleton  
Mr Anson  
Mr Monck  
Mr Burgner  
Mr Moore  
Mr Mountfield  
Miss Peirson  
Mrs Brown  
Mr Bottrill

*Handwritten notes in red ink:*  
Is a separate  
re cost re IF  
subsidy - not if we  
allow new - we  
for allow  
for this project?

**HARLAND AND WOLFF**

Yesterday Mr Tikkoo and Harlands announced that heads of agreement had been reached for the construction of a major advanced cruise liner - the "Ultimate Dream". The announcement attracted considerable media coverage. Mr King in commenting on the announcement made it clear that he could only consider the case for public support when detailed proposals had been put to him by the company and pointed out that there were many competing claims for public funds. (The Times describes his attitude as very cautiously welcoming).

2. As indicated in Mr King's minute to the Prime Minister of 29 March, it is likely to be the end of the month before Harland's put detailed proposals to him. We will then be involved with his officials in a rapid appraisal of their realism on the basis of which Mr King will explore the options outlined in paragraph 5 of his minute.

3. The value of the contract quoted by Mr Tikkoo yesterday was \$500m (£264m). He made it clear the deal was dependant on the availability of ECGD cover for 80% of the contract price, and Intervention Fund subsidies to Harlands.

4. ECGD have given no commitment on the provision of cover and will need to give careful consideration to proposals that Hambros will be putting forward shortly on Mr Tikkoo's behalf.

5. Given Harland's track record on costings and production it is highly unlikely that the figures that they put to Mr King will be realistic in terms of costing or time of build. They will undoubtedly show the yard as being able to make a 'profit' on the deal, ( allowing for up to 28% (£74m) of Intervention Fund assistance ) but are unlikely to stand up to rigorous appraisal.

6. We are in touch with ECGD and ST3 and AEF2 are agreed that it would be sensible for us to ensure that consideration of Hambros proposals for cover does not run ahead of officials consideration of Harlands bid for contract support.

7. For the latter, which will include professional input from Touche Ross, we will be on a very tight timetable if Mr King is to take a decision on Harlands by the end of May, as proposed in his minute of 29 March. Much will depend on the extent Mr King and his officials retain their scepticism about the 'Ultimate Dream' when faced with Harlands costings at the end of this month.



A M WHITE

2 MARSHAM STREET  
LONDON SW1P 3EB  
01-212 3434

My ref:

Your ref:

The Rt Hon Nigel Lawson MP  
HM Treasury  
Parliament Street  
LONDON  
SW1 3AG

CH/EXCHEQUER ✓ 20/4	
REC.	20 APR 1988
ACTION	MRS BROWN
COPIES TO	CST, FST, SRP, MIDDLETON MR ANSON, MR MONCK, MR D MOORE, MR BURGNER MS SEAMEN, MR WALLER MR A M WHITE, MR R EVANS MR GUY, MR SHARRATT MR RUTAN, MR N WILLIAMS MR CALL

20 April 1988

Dear Chancellor,

## SHIPBUILDING

You copied to me your comments of 30 March on the paper by the Chancellor of the Duchy of Lancaster of 28 March, of which I have also now seen a copy. I understand that at the Ministerial meeting on 31 March my proposal to include an EZ in the package of remedial measures for Sunderland in response to shipbuilding redundancies was given approval. Our officials are working on the detailed case.

I agree with your argument that our responses to such redundancies should be even-handed between the territories. For that reason I felt that there was a strong political argument to supplement the good technical case for a Sunderland EZ. I note your request that we should look to fund the remedial measures from within existing provision. I fully accept this in relation to the foreseen UDC expenditure within the proposed zone, where the costs of my proposal would be drawn from the UDC's provision (however, you would not expect me at this stage of the PESC cycle to commit myself for future years on the overall UDC programme.) The RSA costs will fall to DTI and Kenneth Clarke covered this in his original minute. The main zone benefits of rates and tax relief are not, of course, public expenditure costs.

I am copying this to the Prime Minister, David Young, Malcolm Rifkind, Tom King, Kenneth Clarke and Sir Robin Butler.

Yours sincerely  
A D L

PP

NICHOLAS RIDLEY

(Approved by the Secretary of State  
and signed in his absence)

*BE 2774 pp*



FROM: J M G TAYLOR  
DATE: 21 April 1988

*Tony D  
Can I see X p?*

PS/FINANCIAL SECRETARY

cc Mr Scholar  
Miss Sinclair  
Mr Battishill - IR  
Mr Isaac - IR  
Mr Painter - IR  
Mr McGivern - IR  
Mr Lewis - IR  
PS/IR

*mgh*

**SHIPPING: EVIDENCE TO THE TRANSPORT SELECT COMMITTEE**

X The Chancellor has seen Mr Lewis's minute of 14 April to the Financial Secretary, enclosing the proof of the evidence given by officials to the Transport Select Committee on 22 March.

2. He has commented that officials handled this well.

*JMGT*

J M G TAYLOR



SECRET



10 DOWNING STREET  
LONDON SW1A 2AA

CH/EXCHEQUER	
REC.	21 APR 1988 <i>21/4</i>
ACTION	Mrs BRAIN
COPIES TO	CST FST SIR P. MIDDLETON MR ANDERSON MR MONCK MR MAURE MC BURGHNER MR BEAMON MR WALLER MR ALWITTE MR EVANS MR GUY, MR SHARRAFT MR WILLIAMS MR RICHAM
21 April 1988 M RALL	

From the Private Secretary

*Dear David,*

*phf*

SHIPBUILDING

Thank you for your letter of 14 April concerning the record of the meeting on 31 March.

I have looked carefully at my notes, and consulted the members of the Cabinet Office Economic Secretariat who have done likewise. Our agreed conclusion is that the minutes of the meeting were accurate; we have no record of the point in the first sentence of the second paragraph of your letter, or of any reference to Mauritius.

I suggest the best way forward is for your Secretary of State to raise the points of concern to him when the further paper the Department of Trade and Industry are now preparing is discussed. This paper will need to address the outstanding issues on all the UK shipyards, and we are planning that the paper should be taken at an early meetin gpf E(A).

I am copying this letter to the Private Secretaries to the Chancellor of the Exchequer, the Secretaries of State for Northern Ireland, and Trade and Industry, the Chancellor of the Duchy of Lancaster, the Parliamentary Under-Secretary of State for Defence Procurement, MOD, and to Sir Robin Butler, Mr. Richard Wilson and Mr. George Monger (Cabinet Office).

*Yes.  
P.G.*

PAUL GRAY

David Crawley, Esq.,  
Scottish Office.

SECRET

CONFIDENTIAL



FROM: J M G TAYLOR

DATE: 21 April 1988

MR A M WHITE

cc PS/Chief Secretary  
PS/Financial Secretary  
Sir P Middleton  
Mr Anson  
Mr Monck  
Mr Burgner  
Mr Moore  
Mr Mountfield  
Miss Peirson  
Mrs Brown  
Mr Bottrill

*bf. 25/2*

**HARLAND AND WOLFF**

The Chancellor has seen your minute of 20 April. He has asked whether it is definitely the case that Intervention Fund subsidies - even if we favoured them - would be allowed for the project.

2. I should be grateful for advice.

A handwritten signature in black ink, appearing to be 'J M G Taylor'.

J M G TAYLOR



*Handwritten initials*

FROM: J M G TAYLOR  
DATE: 21 April 1988

MRS M E BROWN

- cc PS/Chief Secretary
- PS/Financial Secretary
- Sir P Middleton
- Mr Anson
- Mr Monck
- Mr Burgner
- Mr D J L Moore o/r
- Mr White
- Mr Guy
- Mr Rutnam
- Mr Call

**BRITISH SHIPBUILDERS**

The Chancellor has seen your minute of 20 April. He spoke to Mr Clarke in the margins of Cabinet this morning. Mr Clarke gave him an assurance that there is no question of agreeing Intervention Fund support for Govan as well as a dowry.

*Handwritten signature*

J M G TAYLOR



# General Council of British Shipping

30/32 ST. MARY AXE LONDON EC3A 8ET  
Tel: 01-283 2922 01-626 8131 Telex: 884008 & 884768 SMA-G  
Facsimile: 01-626 8135 (Group 3)

13/1

21 April, 1988.

Mr Eugene McGivern,  
Inland Revenue,  
Somerset House,  
Strand,  
LONDON WC2R 1LB.

Dear Eugene,

## BUSINESS EXPANSION SCHEME

The new rules imposing limits on the total amount that any company can raise under the Business Expansion Scheme in any period of 12 months contain the exception for 'companies letting ships on charter' and the limit for these is £5 million.

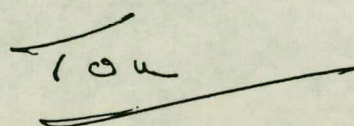
Before ship-chartering was brought within the terms of the BES rules it was possible to set up a BES shipping company if the company operated the ship itself, for instance a ferry or container ship business on own account. The reason why the GCBS pressed so hard for the inclusion of ship-chartering was that in bulk operations the ship is invariably chartered out.

The point we wish to raise is, do the new rules for the £5 million limit apply only to cases where the ship is chartered out, thereby restricting an 'own account' operation to £500,000? The reason for the higher limit for BES ship companies is that ships are discrete high-cost units of plant and this can apply regardless of how the ship is actually operated.

The wording in the Finance Bill refers to a trade consisting 'wholly or substantially wholly of letting ships, other than oil rigs or pleasure craft, on charter'. How will this be construed? If it is construed narrowly then the GCBS will no doubt seek to put an amendment down bringing an 'own account' ship within the £5 million limit. If construed broadly, does the wording in the Bill need slight amending?

I would be very grateful if we could have an early reply as Committee Stage will be upon us soon.

Yours sincerely,



T.S. DONAGHY  
Tax Adviser

T S Donaghy Esq

BUSINESS EXPANSION SCHEME

Thank you for your letter of 21 April. I confirm that the £5 million limit will apply only to companies letting ships on charter. If a company owns and operates a ship the limit will be only £500,000.

The reason for this distinction is that we understand that ship-chartering is the normal way of operating larger ships and this is the route chosen by the only big BES shipping issue (Edinburgh Tankers). In principle, it would be possible to extend the £5 million limit to owner-operators. But there would need to be special legislation to define these. This is of course a matter for Ministers but I am sure that they would welcome the views of the GCBS about whether much use would be made of such a relaxation. There is also the question of precisely what this should cover. Do you have in mind something along the following lines:

- i. the company's trade must consist wholly or substantially wholly of operating ships, other than oil rigs or pleasure craft;
- ii. every ship operated by the company must be beneficially owned by it and must be registered in the UK?

I should point out that the company would of course have to comply with the requirement that its trade must be carried on wholly or mainly in the UK. Whether or not this condition is satisfied depends upon all the

relevant facts. But it seems likely that the ship or ships would have to operate out of UK ports in order to satisfy this condition. This contrasts with the position of a ship chartering company but as you know the trades are of a different kind.

Once I have your reply I shall put your proposal to Ministers for their consideration.

E MCGIVERN

**SECRET**

FROM: J M G TAYLOR  
DATE: 21 April 1988

*php*

PS/CHIEF SECRETARY

cc PS/Financial Secretary  
Sir P Middleton  
Mr Anson  
Mr Monck  
Mr D J L Moore  
Mr Burgner  
Ms Seammen  
Mr Waller  
Mr A M White  
Mr R Evans  
Mr Guy  
Mr Sharratt  
Mr Rutnam  
Mr N Williams  
Mr Call

**BRITISH SHIPBUILDERS**

You will have seen a copy of the Chancellor of the Duchy's letter of 18 April to the Chancellor.

2. Mr Clarke says that he had assumed that the Chancellor's minute of 30 March, circulated with my letter of 7 April, was primarily for the record since the Chancellor did not raise the question of Departmental contributions at the Prime Minister's meeting on 31 March. The Chancellor has commented that the meeting in question closed because the Prime Minister ran out of time before this point was discussed. Thus at no time did Mr Clarke make any claim on the Reserve.

3. The Chancellor has commented, further, that it is clearly essential that the Chief Secretary seeks to sort out bilaterally, as soon as possible, the question of the contributions that DTI make to the costs of BS-related special measures.

*JMG*

J M G TAYLOR

FROM: M SHARRATT  
DATE: 22 APRIL 1988

- 1. MR WHITE
- 2. FINANCIAL SECRETARY

- cc Chancellor
- Chief Secretary
- PMG
- EST
- Sir Peter Middleton
- Mr Anson
- Mr Philips
- Mr Monck
- Miss Peirson
- Mr Burgner
- Miss Noble
- Mrs Brown
- Mr Waller
- Mr Call

*Lancebury  
now in  
H&W  
see X in 1-7-76  
paper  
BL*

**E(A)(88)24: JAMES MACKIE & SONS LIMITED**

Mr King's memorandum outlines his alternative proposal for the rescue of James Mackie which avoids formal public ownership. This would involve the Industrial Development Board taking a one third shareholding in the company and exercising control through powers to determine the composition of the Board of Directors and senior management. The proposals would still require a total cash injection of up to £20 million in three tranches of £6 million, £8 million and £6 million.

2. In introducing his paper, Mr King may say that following E(A)'s decision not to agree his earlier proposals, efforts to attract private investment have been nugatory and the result has simply been a delay of nearly a month in mounting a rescue of Mackies.

3. The response to that is threefold:

(i) the possibility of a contribution from private investors has been tested in the most favourable part of the market and we are now sure that that is not an option at this stage;

(ii) the Bank has reminded his officials of Lazard's suggested structure for the company which avoided public ownership as colleagues had insisted;



(iii) the necessity to replace the existing management had had been given additional weight.

[mt?]

Line to take

4. There is no commercial or economic case for supporting Mackies. While colleagues may be sympathetic to a government funded rescue on political grounds, you should draw attention to the inherent risk in Mr King's proposal. If despite new management and the injection of substantial government funds, the company's financial position cannot be improved sufficiently for the IDB to dispose of its interests, IDB could be permanently committed and in particular, exposed for all the company's net liabilities if it was get into further difficulty and eventually collapse.

5. You should argue that closure of the company after government has been involved in the running of the company would be seen as a government decision to withdraw support. It is better to avoid that real risk and let the decision to close Mackies be taken by the present Board as an unavoidable commercial outcome of its current and projected financial position. There must be less risky and economically better ways of providing assistance to West Belfast than supporting Mackies.

6. If despite these arguments, colleagues take the view that Mr King's plan must be supported on political grounds, I recommend that you insist that before any funds are provided, Mackies' management must be replaced and strengthened.

Background

7. E(A) on 29 March decided that Mr King's proposal to take Mackies into public ownership was unacceptable and in consultation with the Bank of England, he was asked to look for an alternative rescue plan which avoided this. Bank officials were quick to respond over the Easter holiday period. They had already identified Investors in Industry as offering the best prospect of mounting a rescue with private sector help and within a few days of the initial approach, Mackies was considered at the highest level within 3i.

8. Both on the basis of the financial projections and the weakness of the existing management, 3i concluded that support for Mackies is not a commercial proposition in which they would be willing to invest. Nor did they believe other private sector investment would be attracted in these circumstances. In our view that indicates that further attempts to attract private funds at this stage would be futile; Lazards, Coopers & Lybrand, and Rothschilds had all previously drawn broadly the same conclusion.

9. In reporting the outcome to Northern Ireland officials, the Bank helpfully reminded them of the proposal from Lazards to structure assistance in a way which would avoid formal public ownership and it is this which is the basis of Mr King's revised rescue plan.

#### Mr King's revised plan

10. The revised proposals require the Northern Bank to convert £1 million of its £9½ million overdraft into new ordinary shares and to maintain the reduced £8½m facility. IDB would subscribe for £1m of new ordinary shares and the existing owners would retain the remaining one third interest. In the first stage, IDB would also invest £2½m in non-voting preference shares and provide £2½m as grant or loan. Subsequent IDB funding would be through the acquisition of up to a further £6½m preference shares and up to £7½m further capital grants and loans. We understand that IDB has the necessary powers to mount such a plan and that the total aid package would fall within EC limits.

11. Although it was referred to in the draft that NI officials had shown to us, Mr King's paper does not draw attention to the additional sums which IDB might be liable for if the rescue plan was to fail. These contingent liabilities could be considerable and could include all claims against the present company and its 1972 predecessor. His officials have alerted the E(A) secretariat to this omission.

12. Mr King justifies his plan on the political and social consequences of closure. He will undoubtedly refer also to the grave positions of both Harland & Wolff and Shorts (where our

latest intelligence is that the 1987/88 outturn is much worse than NI Ministers and officials had realised). While the state of the manufacturing and particularly the engineering industries in Belfast is certainly parlous, that does not warrant propping up such lame ducks as Mackies.

Recommendations

13. I recommend that you try to focus the discussion on the inherent risks in Mr King's plan which could lead to even more difficult problems in the future than would be involved in facing up to closure of Mackies now. But if colleagues are prepared to sanction the rescue proposal on political grounds, you should obtain a firm commitment from Mr King that he will bear the costs on his block if the company fails. You should also ask that before the plan is put into effect, Treasury officials are consulted on the detailed arrangements.

*M Sharratt*

M SHARRATT

SECRET

FROM: MRS M E BROWN  
DATE: 22 April 1988

CHANCELLOR

- Chief Secretary
- Financial Secretary
- Sir Peter Middleton
- Mr Anson
- Mr Monck
- Mr Burgner
- Mr Moore (o/r)
- Mr Waller
- Mr A White
- Mr Guy
- Mr N Williams
- Mr Rutnam
- Mr Call

*Thanks. If no work comes to Govt, & we are present. But if support is given for H&W, that might be a sign of a change of attitude. 2. If H&W were to close, then the Govt would have to support a GB. ~~the Govt would have to support a GB.~~ Machines without support.*

**BRITISH SHIPBUILDERS**

This is a position report, following Mr Clarke's Statement on Monday (18 April) about negotiations at Govan. The Statement referred to contractual difficulties at NESL but did not (as Mr Clarke had originally proposed to colleagues) say that there would be no further support for new orders at NESL and other BS yards.

2. Mr Clarke intends to circulate a further paper in 2-3 weeks' time, which will pull together the various current issues on merchant shipbuilding in the UK. 10 May has been provisionally earmarked for a Ministerial meeting. It is hoped that no further public announcement will be needed before then, although that cannot be certain.

3. This note, which includes contributions from IAE and ST, reviews:

- the position on specific issues
- the implications for general policy
- action for Treasury.

Specific issues(i) Govan

Kvaerner have sent British Shipbuilders a letter of intent and a draft business plan, and negotiations are proceeding. The main question is whether Kvaerner will settle on the basis of a one-off dowry, or continued Intervention Fund support. Current discussions are about a dowry, but there is no guarantee that DTI can hold the line on this. You have Mr Clarke's assurance that there is no question of Intervention Fund support as well as a dowry, and we are assured by his officials that you would have an opportunity to comment before negotiations moved from dowry to IF.

(ii) NESL

The customer for the Danish ferry programme\* (the yard's only work) owes BS £16 million. Because of his defaults, contracts for 5 of the ships have been cancelled unilaterally by BS. BS have issued notices of cancellation in respect of 2 further ships. The legal position is very tangled, because the customer may counter-sue for poor workmanship, and ECGD, who are exposed as insurers of related loan agreements, have not yet agreed to further default notices being served. It is likely, however, that the ferry programme will be curtailed, so that work at NESL will run out sooner than expected. DTI say that the workforce have reacted "sullenly" to reports that the yard will close, but at present there does not seem likely to be full-scale industrial action.

*Appledore*

\*The programme is for 24 ships. One is under construction at ~~Angledare~~. 2 have been delivered. 6 are in the Wear, because the purchaser refuses to accept delivery and-or is in default of stage payments due. A further 4 are at various stages of construction and 10 have not been started yet.

(iii) Harland and Wolff

Mr King has not yet received any detailed proposals or costings from Harlands on Mr Tikkoo's "Ultimate Dream". His officials' views are that it will be mid-May before they come forward.

If, as in our view seems likely, they include an application for Intervention Fund support we would see little prospect (contrary to the FT report) for a European Commission challenge to such assistance - that would require there to be other European yards competing for the order at lower rates of subsidy. There are none, as Harlands alone have *offered* a firm design and a tender. We therefore assume that Mr King would *argue* for Intervention Fund support up to 28% if appraisal of the project indicated that H & W could build it 'profitably' on that basis. (Mr Taylor's minute of 21 April asked for advice on this point).

However, we do know that Mr King wishes to see if H & W could be sold to either its *present* management or Mr Tikkoo on the basis of the "Ultimate Dream" order. If that could be achieved, then as with the sale of Govan, we could press for it to be on a 'dowry' basis rather than with the prospect of continuing Intervention Fund support.

But it will be some time before Mr King will be in a position to judge the viability of the "Ultimate Dream". Until he can do so he is likely to resist any decision to debar Harlands from access to Intervention Fund type support.

Enterprise measures

It has been agreed that any announcement of the closure or *effective* closure of NESL should be

accompanied by an announcement of a company to provide counselling, retraining and enterprise promotion in the Area, the undertaking of £7.6 million of advance factory building and the intention to designate a new Enterprise Zone. Only questions of funding are outstanding (see below). Mr Clarke is understood additionally to favour counselling, retraining and enterprise promotion in the Bideford area, and Mr Rifkind similarly in Glasgow and Greenock. Treasury Ministers will not need to object unless Mr Clarke and Mr Rifkind wish to make a bid on the reserve for the necessary resources. Mr Rifkind has yet to take a position on what if any further remedial measures he would wish to press for Glasgow and Greenock, and it remains unclear when he will do so.

### General Policy

The main question for Ministers continues to be the future of Government support for the UK's merchant shipbuilding industry.

The present position is that Intervention Fund support is available for Harland and Wolff and for all British Shipbuilders' and private merchant shipbuilding yards. It is not available for any merchant shipbuilding undertaken by the privatised warship yards, although this is a bone of contention. We must clearly maintain this.

Mr Clarke's preferred position is that IF support should terminate, first for public sector yards and after a decent period of notice to all yards remaining in the public sector. (Only five small private yards spread around the coast are eligible for IF, with total employment between them of 850.) Yards remaining in the public sector (ie British Shipbuilders and Harlands) would from now on receive no support for new loss-making orders, and would therefore have to close when present work ran out.

SECRET

But this position is complicated by Govan and Harland and Wolff. If Intervention Fund support is agreed for Govan, it will be that much more difficult to deny it for Harlands. And if IF is agreed for either of them, there will be great pressure to keep it going for NESL and other BS yards too. We will continue to ensure that Harlands and Govan are considered together, through close co-operation between ST and PE divisions.

Action for Treasury

(a) Expenditure provisions

Our immediate tasks are to

- establish realistic costings for the Govan dowry (plus any other sale costs); closure costs for the other BS yards and businesses; and enterprise measures in the North-East and Scotland;
- reach agreement with DTI and Scottish Office on the amount of new money which will be allowed.

The Chancellor of the Duchy has written to the Chief Secretary emphasising that he will expect all these costs to be met from the reserve. We will be advising the Chief Secretary on a reply early next week, aiming to fix a limit on allowable closure/disposal costs and seeking some - preferably full - offsets to provision for remedial employment measures in the current year. Costs in future years would need to be settled in the Survey.

(b) Financing mechanisms

There is a technical question as to whether payments to British Shipbuilders should continue to take the form of Public Dividend Capital, if what amounted to a closure announcement was made; and whether drawings would be needed from the Contingency Fund. These points are being urgently considered by Treasury and DTI officials.



SECRET

(c) Appraisal of "Ultimate Dream"

We are keeping in close touch with Mr King's officials and will be fully involved in the appraisal exercise. We have alerted ECGD to our views on Harlands capabilities and performance and to the need for them to pace their consideration of credit cover for Mr Tikkoo so as not to run ahead of consideration of Harlands' case for support on the contract.

We are keeping in close touch with DTI officials about events at Govan and NESL, and with NIO on Harlands, and will update you as soon as there is further news. You may wish to circulate a paper for the next Ministerial meeting, supporting Mr Clarke in his determination to end IF subsidies. Depending on how events move at Harlands and Govan, you or the Chief Secretary may wish to write separately and sooner about the implications of agreeing continued support for either of these yards.

Mary Brown.

MRS M E BROWN

SECRET



FROM: J M G TAYLOR  
DATE: 25 April 1988

A handwritten signature in black ink, appearing to be 'JMG'.

MRS M E BROWN

cc PS/Chief Secretary  
PS/Financial Secretary  
PS/Paymaster General  
PS/Economic Secretary  
Sir P Middleton  
Mr Anson  
Mr Monck  
Mr Burgner  
Mr Moore  
Mr Waller  
Mr A White  
Mr Guy  
Mr N Williams  
Mr Rutnam  
Mr Call

**BRITISH SHIPBUILDERS**

The Chancellor was grateful for your minute of 22 April.

2. He has commented that, if the worst comes to the worst, and we are persuaded that IF support must continue for Harland and Wolff, for special Northern Ireland reasons, that must not prevent the cessation of IF support in the rest of the United Kingdom.

3. He has commented, further, that if Harland and Wolff were to avoid closure, then the case for saving Mackies would virtually disappear.

Handwritten initials 'JMG' in black ink.

J M G TAYLOR

FROM: A M WHITE  
DATE: 25 APRIL 1988

CHANCELLOR

cc Chief Secretary  
Paymaster General  
Financial Secretary  
Economic Secretary  
Sir P Middleton  
Mr Anson  
Mr Phillips  
Mr Monck  
Miss Peirson  
Mr Burgner  
Miss Noble  
Mr Brown  
Mr Waller  
Mr Call

**E(A)(88)24: JAMES MACKIE AND SONS LIMITED**

You asked for a note on the state of play on Harlands and Short's as background for this afternoon's discussion on James Mackie.

2. I attach a note which includes material gathered over the weekend that spells out further the difficulties at Shorts which we referred to in passing in Mr Sharratt's submission on 22 April.

  
A M WHITE

## HARLAND AND WOLFF

The latest news from Harland is generally more upbeat than for some considerable time. But in our view this renewed confidence is based on future expectations and very little actual achievement.

2. One factor has been the final delivery to MOD of the air training ship (ATS). But it was one year late and £26 million (40 per cent) over the contract price. Of the remaining contracts, the SWOPS for BP is running six months late and is entering the difficult commissioning stage - which is where the ATS ran into major problems. Forecast outturn cost is already 20 per cent above the contract price and could easily increase further over the next few months. The final order is the AOR and although still at a very early stage, Harlands are seeking MOD's agreement to a nine month extension.

3. The forecast results for 1987-88 are better than the revised budget both in terms of trading loss (down £3.3m to £7.5m) and cash requirement (down £10m to £53½m). But this is due to reduced activity and expenditure because of delays.

4. The major development is the proposed cruise ship order for Mr Tikkoo. Harlands are still costing the proposal and it will be mid-May before they commit themselves to a tender price. Mr Tikkoo has quoted a contract price of \$500m for which he is seeking ECGD cover of up to 80 per cent and we expect Harlands will be seeking Intervention Fund subsidies of 28 per cent. So far, neither NI nor Treasury officials have received any proposals from the company.

5. On the basis of their present information, ECGD believe there would be little difficulty for Mr Tikkoo in putting together a financing package for which, in principle, they could provide a substantial proportion of cover. But as stated in Mrs Brown's submission of 22 April, we have asked ECGD officials to pace their consideration of credit cover for this proposal to fit in with consideration of the case for support for Harlands on this contract.

6. We are at least a month away from being able to offer informed advice on the 'Ultimate Dream' but the advanced nature of the concept combined with our knowledge of Harlands performance and weakness on costings give us no reason to believe that the ship could be built without subsidy. For that subsidy to take the form of Intervention Fund support would pose undoubted risks to Mr Clark's preferred approach to British Shipbuilders, which we strongly support. You should avoid in today's discussion any hint that (as in Mr Taylor's minute of 25 April) you would in the final analysis be prepared to see Intervention Fund support given to Harlands on this contract.

(A very odd construction to please on my minute?).

### Shorts

7. This aircraft, aerostructures and missiles business is in poor shape, with poor performance on the aircraft side dragging down the technical excellence of the aerostructures business and the profitable, highly regarded missiles division.

8. The final plan of the ex-chairman, submitted last autumn nonetheless envisaged the company continuing its present pattern of activities through seeking a collaborative partner to build a small/medium passenger jet.

9. We were able to convince Mr King's officials that this plan did not provide an adequate basis for continued support for the company and that Mr Lund, the newly appointed chairman, should complete an urgent review of the company and report on how he saw the company being shaped in future. That report is due at end June to allow consideration before the summer break. We would hope that it will point the way towards withdrawal from the civil aircraft business (assembly of the Tucano trainer for the RAF would continue) and a concentration with a somewhat reduced work force on aerostructures and missiles (Shorts currently employ some 7500 and are the biggest manufacturers in Northern Ireland).

10. Mr King had been about to write to colleagues last week proposing to defer discussions on the company until Mr Lund's report was available when it came to light that there had been a

massive breach in the EFL for 1987-88, the outturn on which was now put at £120m, as against the £88m reported by Touche Ross, who monitor the company for Mr King, earlier this month.

11. Reports by Touche Ross <sup>and</sup> Deloittes, the company's auditors into the causes of this overshoot are expected today and are likely to point to serious failings in recording and processing payments in the Treasurers and Cashiers department of Shorts as the main cause of this debacle.

12. This dramatically worse result calls even more into question the previous boards strategy and the need for urgent action to improve Shorts financial management and may also raise questions over the quality of Touche Ross' monitoring.

13. While an early paper from Mr King can be expected on this debacle, he is likely to argue that decisions on Shorts, probably leading to a reduction in employment should still await Mr Lunds report ie should not be taken until mid summer.

#### Implications for Mackies decision

14. Mr King will not be in a position to take decisions on Harlands for at least a month. Depending on the reports he will be <sup>receiving</sup> necessary from Touche Ross and Deloittes this week, he is likely to argue that Shorts will not be ripe for decision until the summer.

15. Even if he believes that Harlands proposals for the 'Ultimate Dream' will fend off closure of that yard and that he can also persuade colleagues that Shorts should continue, perhaps in a narrower area of activity, he is unlikely to accept that such decisions would vitiate his political case for Mackies.

16. Both Harlands and Shorts are East Belfast firms with an overwhelmingly Protestant work force. Mackies, located in West Belfast <sup>is</sup> one of the few firms to employ a mixed labour force (70% Protestant 30% Catholic) and, if anything, the continued support of Harlands and Shorts would in Mr King's eyes add to the

difficulties of letting Mackies fall - although that would be the economically sound course to follow. However, if a decision in favour of support for Mackies commands general support on political grounds you may wish to stress the need for respecting economic realities when H&W and Shorts come forward for decision.



Inland Revenue

Policy Division  
Somerset House

FROM: J H REED  
DATE: 26 APRIL 1988

- 1. MR MCGIVERN
- 2. FINANCIAL SECRETARY

*This is the first occasion  
this possible extension of  
BES to ship owning  
and operating companies (as opposed to chartering)  
has been raised into us. It might be of  
some minor benefit to the industry, but if  
successful, could squeeze out some investment  
in smaller companies.*

BES: SHIPPING

The £5 million limit on the amount a company can raise under the BES in any year applies only to ship chartering companies (and companies letting private rented accommodation). It does not apply to shipping companies which own and operate ships (to which the normal £500,000 limit will apply). The reason we did not recommend giving them a £5 million limit was that ship chartering seems to be the normal way of operating larger ships. And there was an existing definition of this in the BES legislation while this is not the case for shipping companies which operate the ships they own.

*JHG  
26/4*

X

2. The General Council of British Shipping have written to us about this point (copy of letter attached). We propose to reply along the lines indicated above and asking them whether extending the £5 million limit to owner-operator shipping companies would be likely to be of significant use in practice. We would also ask them what precisely a company would have to do to qualify for the extension (a copy of the draft reply is attached).

3. Once we had their reply we would report back to you. Are you content with this proposed course of action?

*YH  
X is 'yes',  
v. 27/4/88  
all as before*

J H REED

- cc PS/Chancellor
- Mr Revolta
- Miss Sinclair
- Mr Cropper
- Mr Saunders (OPC)

- Mr Painter
- Mr McGivern
- Mr Cleave
- Mr Beighton
- Mr German
- Mr Reed
- Mr Arnold
- PS/IR



RESTRICTED



FROM: J M G TAYLOR

DATE: 27 April 1988

A handwritten signature in dark ink, appearing to be 'JMG'.

PS/FINANCIAL SECRETARY

cc Mr Revolta  
Miss Sinclair  
Mr Cropper  
Mr Saunders - OPC  
Mr Painter - IR  
Mr McGivern - IR  
Mr Reed - IR  
PS/IR

**BES: SHIPPING**

The Chancellor has seen Mr Reed's note of 26 April.

2. He has noted that we propose to ask the GCBS whether extending the £5 million limit to owner-operated shipping companies would be likely to be of significant use in practice. He has commented that if the answer to this question is "yes", it will be very difficult not to allow the extension.

A handwritten signature in dark ink, appearing to be 'JMG'.

J M G TAYLOR

BF 29/4

FROM: A M WHITE  
DATE: 27 APRIL 1988

my

FINANCIAL SECRETARY

cc **Chancellor**  
Chief Secretary  
Paymaster General  
Economic Secretary  
Sir P Middleton  
Mr Anson  
Mr Phillips  
Mr Monck  
Miss Peirson or  
Mr Burgner  
Miss Noble  
Mrs Brown  
Mr Bradley  
Mr Waller  
Mr Sharratt  
Mr Call**JAMES MACKIE**

Following the discussions at E(A) on Monday I understand that Mr King has asked Mr Viggers to get in touch with you to explore urgently a solution along the lines of the Prime Minister's summing up. Mr Viggers is hoping to have a word with you at 7.00 this evening.

2. Northern Ireland officials initial view was that the package Mr King proposed to E(A) should simply be reshaped to eliminate the proposed holding of ordinary shares and increase the proposed preference share component of the package.

3. I have told them that such a transparent substitution of preference shares for ordinary shares would be unlikely to commend itself to Treasury Ministers and was difficult to reconcile with E(A)'s clear view against equity involvement. Rather than pursue that course they should urgently consider with Lazards, who have been advising them on Mackies, whether a package can be devised that meets the E(A) remit - a secured loan subject to conditions that allowed the company to continue trading but which did not require the Government to assume responsibility for Mackies past liabilities.

CONFIDENTIAL

CONFIDENTIAL

4. My own view is that given the company's position and the extent of its overdraft to the Northern Bank any security that the company could offer would be of very low quality indeed. In all probability they would have nothing substantial to offer and I would expect Lazards to rapidly confirm that view.

5. Given that, any decision to make funds available to Mackies by way of loan would need to be taken on political grounds, and in the expectation that with strengthened management the business will be able to return to full commercial viability and offer some return on Government funds committed.

6. Consequently I have stressed to Northern Ireland officials the importance that must be attached to any revised proposals being cast in such a way as to avoid the risk of Government becoming liable for Mackies past debts.

7. In any discussion with Mr Viggers this evening you may wish to indicate to him that you would not favour investment by way of preference shares and stress the prime importance of any proposals he may wish to come forward with avoiding the risk of the Government being 'beagled'. We are considering urgently whether there is any further advice we can give to Northern Ireland officials to supplement that they are seeking from Lazards.



A M WHITE

CONFIDENTIAL



Clarke's wife.  
No mention of  
was made. I  
was agreed with  
that he  
announced no  
closure

man

Scott

Ch.

B. Shipbuilders

① K Clarke's office telephoned. Apparently Mr Clarke thinks that you agreed privately with him that additional funds would be made available. (He thinks you agreed this with him in the margins of a meeting yesterday). Is this so?

closure of  
most  
with  
Mr.

② I understand from P Gray that the PM has said she sees no need to make a statement until we are clearer on content, and until the money position is sorted out.

29/4

North East Shipbuilders

3 The situation is entirely different, however, in the case of NESL. The news of the contractual dispute has been widely interpreted as signalling the end of work for the Sunderland yards. The workforce is extremely apprehensive about the future. This makes the task doubly difficult for the BS Chairman, John Lister, and his managers. The local Labour MPs have also been trying to whip up concern. I have had meetings with them and, as might be expected, they have tried to make what capital they could out of the present uncertainty.

4 I also go back to the position we reached in our discussions last Autumn. We then anticipated the eventual rundown of work at NESL. We identified a possible package of alternative measures and agreed that we should aim for an early announcement so as to get the measures up and running as far in advance as possible of work on existing orders running out. I am convinced this is still the right approach. I therefore would like to make a statement on Tuesday 3 May announcing that NESL will not take any more subsidised orders and that we shall be introducing a package of remedial measures forthwith. I attach a draft.

TO:  
PRIME MINISTER

FROM:  
KENNETH CLARKE  
28 April 1988

CH/EXCHEQUER	
REC.	28 APR 1988
ACTION	Mrs BROWN
COPIES TO	CST, FST, SIR P. MIDDLETON, MR ANSON, MR MONCK, MR D. MOORE, MR BURGNER, MR SEAMMEN, MR WALLER, MR A.M. WHITE, MR REEVANS, MR GUY, MR SHARRATT, MR RUTNAM, MR N. WILLIAMS, MR CALL.

Ch. 'X' in para. 6, is a v. large attempted bounce. We shall seek urgent advice tomorrow a.m.

(I think you may still have the earlier pps. on this?)

1 25  
Sorry 28/4

done 28/4

**BRITISH SHIPBUILDERS**

1 At your meeting on 18 April we agreed that I should proceed with a short statement that afternoon informing the House that Kvaerner was seriously interested in acquiring the Govan yard and that there were severe contractual difficulties with the Danish ferry contract at North East Shipbuilders (NESL) at Sunderland. Since then there has been considerable speculation in the Press and elsewhere on the future of the Govan and NESL yards.

Govan

2 In the case of Govan, negotiations are proceeding satisfactorily between BS and Kvaerner. There is some way to go, however, both on the detailed terms and with respect to the European Commission who wish to consider carefully the idea of a dowry rather than continuing Intervention Fund support. But there is no difficulty in our maintaining the position I announced last week.

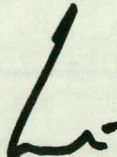
X / discussed the measures that these merited new expenditure as part of the price for withdrawing continued subsidies. I hope we can now proceed on this basis.

### Conclusion

7 My strong preference would still have been to make the wider announcement I put to you and colleagues on 18 April, that we were ending Intervention Fund support for public sector yards in Great Britain. This would have marked a clear end to the huge losses which BS have incurred on contracts. It would have strengthened our hand in negotiations with the European Commission and would have helped to achieve our agreed aim of selling Govan to Kvaerner on a dowry basis. I accept that colleagues wish to discuss the wider policy implications further.

8 I cannot remain silent and inactive on the obvious crisis in Sunderland. I think we must now proceed with an announcement on Sunderland alone. I invite you and colleagues to agree that I should make a statement in the terms of the attached draft on 3 May.

9 I am copying this minute to Nigel Lawson, Tom King, Nicholas Ridley and Malcolm Rifkind and to Sir Robin Butler.



5 Ideally I would have liked to have made the statement when the position on the Danish ferry contract was clear. This will, however, take some time. The existing order was for 24 ferries. The keels have so far been laid for 12. I have already told the House that failure of the Danish contractor, Mr Johansen, to pay the necessary instalments has led BS to cancel the build contract for 5 of the ferries. BS will finish these and sell them separately. There is serious doubt that Johansen is able to finance the full programme. He is technically in default on the loan agreements. I understand from ECGD, who are guaranteeing the loans, that this is not unusual for a major contract of this kind although the latest negotiations between BS and his lawyers suggest he is indeed in genuine difficulty. In any event, I go back to the point that the sooner a statement is made the better. We are at present in a position to guarantee work for the immediate future but the longer the delay the more doubtful this becomes and the less time there will be to get our agreed package of measures in place.

#### Alternative Measures

6 The measures I would propose to announce for Sunderland are precisely those we agreed at your meeting on 31 March. There remains an outstanding issue as to how these will be financed. I have made clear on every occasion that we have



Turning to the broader picture, I am convinced that any general recovery in merchant shipbuilding demand is likely to be short-lived. There is, moreover, more than enough capacity worldwide to absorb any such increased demand. In those circumstances it is impossible to see any long-term future for the yards in Sunderland.

It is not just commercial commonsense which says that North East Shipbuilders has to close. I believe that it is in the long-term interests of the people of Sunderland that the Government should now invest in the future of the town rather than make further unavailing efforts to preserve the past. I am satisfied that the Government can now do more for Sunderland by spending taxpayers' money on encouraging modern jobs and a modern economy rather than by merely postponing the day that we all in our hearts know must ultimately come to shipbuilding in the town.

No one who knows the North East can be in any doubt as to the enormous problems that Sunderland will face as work in the yards finishes over the next few months. But this is not the end of the road for the area or for those who presently work in the yards. The economy of the North East is reviving fast with large new investment from companies like Nissan on the one hand, and a surge in self-employment on the other. We must now accelerate that process of growth.

## NORTH EAST SHIPBUILDERS

Mr Speaker, on 18 April, I told the House of the serious situation which has developed in regard to the contract for the Danish Ferry programme at North East Shipbuilders in Sunderland. I also explained that there was no firm prospect of any future orders for the yard, and that, viewed against the background of huge overcapacity in the shipbuilding industry worldwide, the outlook for NESL was bleak. I also undertook to keep the House informed and to end as soon as possible the uncertainty facing NESL and the people of Sunderland.

I very much regret to have to report that the negotiations between British Shipbuilders and their Danish customer are still proving to be very difficult. There has to be considerable doubt as to whether the programme will be completed although for the time being work will continue.

I have to say to the House that the problems confronting British Shipbuilders over the Danish contract at North East Shipbuilders are merely the latest in a long line. Since 1979, we have lost over £300 million of taxpayers' money in support of this yard. There can be no doubt as to this Government's commitment to shipbuilding at Sunderland thus far.



the department for Enterprise

SECRET

Mr Speaker, today's announcement means that the Government is facing up to reality and to our responsibilities to help build a more secure future for the area. When Consett was closed, people predicted that the town would never recover. They were wrong. It is never an easy decision to close a site that has such historical and symbolic significance, but I have to say to the House that it is the right one.

CD1AAL

and change, and I am therefore announcing a £27.5m package of special measures to encourage the local economy and to help generate new jobs.

My Rt Hon Friend the Secretary of State for the Environment intends to establish an Enterprise Zone in Sunderland to promote new job opportunities through attracting new investment and stimulating the expansion of existing businesses. Subject to the approval of the European Commission, he will make an announcement on this shortly. In addition, I propose to ensure that new factories will be built, as soon as possible, on several sites to provide advance factory space for new and expanding businesses in the Sunderland area. We have allocated £7.5m of the new public expenditure in the coming financial year for this programme of factory building in Sunderland.

To manage this activity we shall establish a new Enterprise company under the Chairmanship of John Lister, the Chairman of British Shipbuilders. This will carry out the full range of training, counselling and replacement activities previously undertaken by British Shipbuilders Enterprise Limited. In addition it will place a much stronger emphasis than British Shipbuilders Enterprise Limited was able to do on the promotion of new enterprise and new jobs.

SECRET

cc: Chief Secretary  
 Financial Secretary  
 Sir P Middleton  
 Mr Anson  
 Mr Monck  
 Mr Moore  
 Mr Burgner  
 Mrs M E Brown  
 Miss Seammen  
 Mr Waller  
 Mr A White  
 Mr Guy  
 Mr N Williams  
 Mr Rutnam  
 Mr Call



29/4/88

Treasury Chambers, Parliament Street, SW1P  
 01-270 3000

PRIME MINISTER

I have seen Kenneth Clarke's minute to you of 28 April, and the draft statement he proposes to make next Tuesday.

I agree with Kenneth that we should make public as soon as possible our intention to run-down the Sunderland yards. There is no prospect of maintaining them without continuing - and excessively costly - Government support. Before a further announcement is made, however, I think we should have an early discussion, as agreed at your meeting on 18 April, to agree our policy on the future of British Shipbuilders as a whole. The announcement could then make clear what that policy is. Otherwise we may appear simply to be reacting in a piecemeal fashion to events as they occur.

I continue to endorse the proposals made in Kenneth Clarke's minute to you of 18 April. Our policy in relation to the Corporation must be to encourage private sector purchasers for as many of the facilities as possible; but to agree that there should be no more support for new orders in any yards remaining in BS hands. We have to grasp the nettle sooner or later and make this basic principle of our policy known publicly.

Some specific points will need to be sorted out before an announcement is made.

We need to clarify what should be said about the timing of the withdrawal of support, for those yards where private sector interest has been expressed.



John Major is writing separately about financing to Kenneth Clarke.

A statement on BS obviously raises questions about the position at Harlands. We may need to reserve our position on that until costings for the cruise ship are available. But I certainly see no reason for delaying an announcement on BS until all uncertainties at Harlands (and other yards) are resolved.

I am copying this minute to Kenneth Clarke, David Young, Malcolm Rifkind, Tom King, Nicholas Ridley and to Sir Robin Butler.

*John Major*

pp. [N.L.]  
29 April 1988

[Approved by the Chancellor  
and signed in his absence]

SECRET

CHANCELLOR

FROM: MRS M E BROWN  
DATE: 29 April 1988

- cc Chief Secretary
- Financial Secretary
- Sir P Middleton
- Mr Anson
- Mr Monck
- Mr Moore
- Mr Burgner
- Miss Seammen
- Mr Waller
- Mr A White
- Mr Guy
- Mr N Williams
- Mr Rutnam
- Mr Call

*OK: a few days*

*Ch. / Content to write as proposed (if you agree, I will sign on your behalf so this can go tonight).*

*'X' in para. 7. This submission has not yet arrived. Since the PM does not want a rush job, I think this can safely go to the CST for his wife box. Agree?*

*Must [unclear] for her. [unclear] with this.*

*29/4*

**BRITISH SHIPBUILDERS**

Mr Clarke's minute to the Prime Minister of 28 April proposes a Statement next Tuesday, 3 May, announcing:

- (i) that NESL will receive no further support for new orders;
- (ii) a package of enterprise measures for the North East.

2. We understand that the Prime Minister's reaction is that she does not want a rushed announcement. We recommend you to minute her, welcoming the idea of an announcement as soon as possible, but saying that a meeting should be held first to clarify policy on BS as a whole. That points to the timetable previously planned of a 10 May meeting, followed by an announcement.

Assessment

3. The advantage of a very quick announcement is that colleagues would have grasped the nettle and committed

SECRET

themselves to the run-down of a major part of BS. The main outlines of the policy you favour would then have emerged de facto: sale of BS facilities (notably Govan) to the private sector where possible; and run-down of the rest. It would then be much more difficult for colleagues to argue that the remaining small yards (Appledore, Clarke Kincaid, Fergusons) should be kept going, if private sector interest in them did not materialise.

4. However, it would be even better to get colleagues' explicit agreement to this policy, rather than just to the closure of NESL; and to announce the policy publicly. Another meeting is necessary to achieve that. We do not think anything will be lost by postponing an announcement for another week or so. Opposition from Mr Rifkind and Mr King may frustrate decisions on more than NESL. But it is worth trying.

5. We think you should take a firm line that policy on BS cannot wait on events at Harlands. The "Ultimate Dream" costings are not expected for some weeks at least. If necessary, a Statement would have to indicate that the position at Harlands is being considered separately. You will presumably want to avoid conceding - certainly for the time being - a special case so far as financial support is concerned.

6. Mr Clarke's minute refers to difficulties in persuading the European Commission to the idea of a dowry for Govan. This is awkward, because we would then have to offer Intervention Fund support. But we do not think you should comment on this point in your minute. The Prime Minister has already agreed that as a last resort Intervention Fund support should be offered to Kvaerner. And that would still be consistent with your overall policy objectives - ie. encouraging private sector purchasers to take over merchant shipbuilding facilities where possible, but withdrawing Government support from any facilities remaining in the public sector.



SECRET

7. Mr Guy is submitting separate advice and a draft letter to Mr Clarke on financing. In the Chief Secretary's absence today you may wish to send the letter, in parallel with a minute to the Prime Minister. | X

8. A draft minute to the Prime Minister is attached. It is agreed with IAE and ST Divisions.

Mary Brown.

MRS M E BROWN

*Be-type final*

SECRET

**DRAFT MINUTE FROM THE CHANCELLOR TO PRIME MINISTER**

I have seen Kenneth Clarke's minute to you of 28 April, and the draft statement he proposes to make next Tuesday.

2. I agree with Kenneth that we should make public as soon as possible our intention to run-down the Sunderland yards. There is no prospect of maintaining them without continuing - and excessively costly - Government support. Before a further announcement is made, however, I think we should have an early discussion, as agreed at your meeting on 18 April, to ~~clarify~~<sup>agree</sup> our policy on the future on British Shipbuilders as a whole. The announcement ~~should~~<sup>could</sup> then make clear what that policy is. Otherwise we ~~will~~<sup>may</sup> appear simply to be reacting in a piecemeal fashion to events as they occur.

3. I continue to endorse the proposals made in Kenneth Clarke's minute to you of 18 April. Our policy in relation to the Corporation must be to encourage private sector purchasers for as many of the facilities as possible; but to agree that there should be no more support for new orders in any yards remaining in BS hands. We have to grasp the nettle sooner or later and make this basic principle of our policy known publicly.

4. Some specific points will need to be sorted out before an announcement is made.

5. We need to clarify what should be said about the timing of the withdrawal of support, for those yards where private sector interest has been expressed.

6. ~~John Major is~~ ~~[I am]~~ writing separately about financing to Kenneth Clarke.

SECRET

7.6. A statement on BS obviously raises questions about the position at Harlands. We may need to reserve our position on that until costings for the cruise ship are available. But I <sup>can't</sup> see no reason for delaying an announcement on BS until all uncertainties at Harlands (and other yards) are resolved.

8.7. I am copying this minute to Kenneth Clarke, David Young, Malcolm Rifkind, Tom King, Nicholas Ridley and to Sir Robin Butler.

NIGEL LAWSON

SECRET



10 DOWNING STREET  
LONDON SW1A 2AA

*[Handwritten signature]*

From the Private Secretary

29 April 1988

*[Red checkmark]*

*Dear Peter,*

**BRITISH SHIPBUILDERS**

The Prime Minister has seen the Chancellor of the Duchy's minute of 28 April and the attached draft statement.

The Prime Minister does not see any need to make a statement about the position at North-East Shipbuilders until the position on the Danish ferry contract is clearer. She also thinks it essential that the position on financing of the package is resolved between your Department and the Treasury before a statement is made.

The Prime Minister wishes the position on all the outstanding shipbuilding issues, including the other BS yards, Harland and Wolff and the future of intervention support for private sector yards to be discussed at the meeting of E(A) scheduled for 10 May. She would be grateful if the Chancellor of the Duchy, in conjunction with other colleagues, could arrange for papers to be prepared for this purpose.

I should be grateful if you could ensure that circulation of this letter is restricted to those who have an operational need to see it. I am sending copies of this letter to Alex Allan (H.M. Treasury), David Watkins (Northern Ireland Office), Roger Bright (Department of the Environment), David Crawley (Scottish Office) and Trevor Woolley (Cabinet Office), and I should be grateful if they could treat this document in the same way.

*Yours,  
Paul*

(PAUL GRAY)

Peter Smith, Esq.,  
Chancellor of the Duchy of Lancaster's Office.

CH/EXCHEQUER	
REC.	29 APR 1988
RECEIVED	MRS BROWN
COPIES	CST
	MR ANSON
	MR WALLER
	MR A M WHITE

*[Handwritten: 12/4]*

SECRET



CH/EXCHEQUER	
REC.	29 APR 1988 ✓ 20/4
ACTION	FST
COPIES TO	

Foreign and Commonwealth Office

London SW1A 2AH

29 April 1988

Dear David

James Mackie and Sons Ltd

The Foreign Secretary has read with interest the minutes of the E(A) discussion on 25 April. He has noted that your Secretary of State envisages no problems with the European Commission over the proposed IDB assistance to James Mackie and Sons. He imagines that the Commission are in any event likely to ask for an explanation of the loan, in order to satisfy themselves as to whether it is notifiable under Articles 92-3 of the EC Treaty. He has asked whether soundings have been taken in Brussels, since the Commission are more likely to respond sympathetically if we have taken them into our confidence in advance and explained the political background.

The Foreign Secretary believes that it would be helpful if the best way of handling the Commission could be covered in your Secretary of State's consultations with the Chancellor about the feasibility of the loan.

I am sending copies of this letter to Alex Allen (HM Treasury), Peter Smith (DTI) and Trevor Woolley (Cabinet Office).

Sons son

(R N Culshaw)  
Private Secretary

David Watkins Esq  
PS/NIO

CONFIDENTIAL

FROM: A R WILLIAMS

DATE: 29 April 1988

1. MR REVOLVA I agree. It is essential to  
2. CHANCELLOR head off any announcement or  
further work by officials, since  
this would create irresistible  
pressures for significant  
additional public expenditure.
- cc PS/Chief Secretary  
PS/Financial Secretary  
Sir P Middleton  
Sir G Littler  
Mr Anson  
Mr Scholar  
Mr Phillips  
Mrs Case  
Miss Peirson  
Mr Robson  
Mr Culpin  
Ms Seammen  
Miss Sinclair  
Mr McIntyre  
Mr Fraser - IR
- DR  
29/4

**MERCHANT SHIPPING AND DEFENCE**

1. The Prime Minister has called a meeting on this subject for 4 May, as a follow up to the one on 23 February. There are two papers, one by you on the taxation of seafarers and one by Mr Channon. Mr Channon's is a compendium, consisting of a covering note and four supporting papers on merchant shipping requirements, offshore manning contracts, the response of other countries to the decline of their fleets, and access to merchant ships in crises and war.

2. Your paper concludes that that there are very strong arguments against either changing the PAYE rules for shipping companies or granting seafarers special tax reliefs. Mr Channon seeks agreement to the following propositions (paragraph 19 of his covering note):

(i) urgent action is needed to ensure that wartime shipping requirements can be met

(ii) every opportunity should be taken to reduce the extra cost of employing British crews

(iii) the Inland Revenue should not seek retrospection beyond the start of 1988-89 when enforcing the operation of PAYE and should look for administrative means of reducing the impact

(iv) the case for alleviating the personal tax and social security burden of the shipping industry should be further examined

(v) a scheme for a contract with owners of vessels in short supply should be worked up

(vi) an announcement that these further measures were being considered should be made

(vii) the position of other types of ship should be kept under review and alternative ways of satisfying the demand for break-bulk ships, including the containerisation of NATO reinforcement supplies, should be examined.

### Line to take

3. On your own paper, you will wish to argue that shipping companies should not be exempt from PAYE obligations and that there should be no special tax reliefs for seafarers (see Speaking Note 1, provided by the Revenue).

4. On Mr Channon's first two general propositions, we recommended that you resist strongly any vague, open-ended decision that "something" must be done to meet wartime merchant shipping requirements and reduce British crew costs. The UK's needs must chiefly be seen in a NATO context. The balance of supply and demand within NATO for wartime merchant shipping has yet to be established. Uncoordinated action by individual NATO countries is likely to be expensive and inefficient, and could lead to conflicting policies. The paper on other countries' responses (paper III) indicates that many NATO countries are already taking such uncoordinated action, though usually not for defence reasons. We should wait for the results of the NATO study, before launching off on our own. But we do not expect that you will be able to secure agreement from colleagues to this inactive approach and therefore your fallback position should be to agree to Mr Channon's proposal for further work on a contract scheme, provided that this is not announced.

5. Hence on Mr Channon's five specific proposals, we recommend the following line (agreed with the Revenue):

- Agree no retrospection for operation of PAYE beyond start of this financial year. But there must be no further delay in telling companies of requirement to operate PAYE. Revenue happy to explore with companies how best to handle operation of 100% Foreign Earnings Deduction in the new circumstances. (More details in Annex A).
- Reject further examination of case for alleviating personal tax and social security liabilities of seafarers (Speaking Note 2).
- Accept working up of scheme to contract for product tankers, provided that decision whether or not to proceed kept open until work has been completed and costed. If something must be done, this is better than tax relief (or untargetted subsidies). But unclear whether scheme proposed will be sufficient to secure increase in British owned <sup>vessels.</sup> vehicles. Treasury officials should be consulted on further work. Cost of any scheme to be contained within existing DTp provision.
- Should be no announcement of what Government considering: would build up expectations which might prove impossible to fulfill. (Speaking Note 3).
- Agree position on other types of ship should be kept under review and that containerisation of military supplies could usefully be examined.

### Background

6. At the previous Ministerial meeting on merchant shipping and defence, Mr Channon argued in favour of roll-over relief for shipping investment, of acceptance that shipping companies did not have to operate PAYE, and of further work on schemes to encourage UK shipping companies to operate vessels of particular strategic importance. In her summing up, the Prime Minister said that Mr Channon had raised a problem that could not be ignored but that more information and further work on available options was needed. A number of papers were called for, of which Mr Channon has produced the following.



7. Paper I, prepared jointly by Mr Younger and Mr Channon, deals with Merchant Shipping requirements in emergency and war. It concludes that the requirements of the UK armed forces can at present be met. But there is a shortage of product tankers of between 10,000 and 40,000 dwt, break bulk general cargo ships and container ships for civil resupply and for transatlantic reinforcement from the US.

8. We have three main comments on this analysis. First, it does not deal adequately with the NATO dimension. NATO has an agreement to pool its shipping in wartime and a study is currently being conducted to assess the supply and demand for merchant <sup>shipping</sup> within NATO as a whole. While it is true that most NATO countries are experiencing a decline in their merchant fleets, until the facts are established we cannot be certain whether and where there is a shortfall within the Alliance as a whole. Hence action by the UK now would be premature. However in one respect Mr Channon's case has been strengthened recently: the consultant advising the NATO study has said that the NATO pool could not supply sufficient product tankers to the UK.

9. Second, the "best case" identified in paper I takes no account of the possibility of chartering foreign owned ships. The prospects of profits, backed up by war risks reinsurance, could attract foreign shipowners. In his covering note, Mr Channon recognises this but says that it would be unwise to rely on this source because the owners concerned might be unwilling to commit themselves at an early stage of a war. We think that it might, nevertheless, be worth taking the risk of relying on a modest contribution from foreign owned shipping if the only alternative was a very expensive scheme to subsidise UK owners. The judgement will depend on how costly the proposed contract scheme turns out to be when examined further.

10. Third, it appears that defence planners are assuming the use of a type of ship, namely break bulk general cargo ships, which are going out of ordinary commercial use. Mr Channon recognises this problem in his covering note and is seeking to deal with it by means other than securing more of these ships in peacetime.

11. Paper II deals with offshore manning contracts. It describes how such contracts have helped UK shipowners to keep their vessels on the British or Isle of Man registers, but concludes that the advantages will be lost if owners are obliged to operate PAYE and collect National Insurance contributions. However Mr Channon accepts that IR has no option but to apply the law on PAYE and in his covering note confines himself to pressing for no retrospection and administrative means of reducing the impact (see also Annex B).

12. Paper III describes other countries' responses to merchant shipping decline. It suggests that within Europe the trend is towards helping owners to reduce crew costs by creating special tax and social security regimes for seafarers. As all of the countries mentioned, except Sweden, are NATO members, if they are successful in maintaining or increasing the size of their merchant fleets, there will be that much less need for the UK to take action.

13. You asked about the position on the European Commission's proposals on taxation of seafarers, mentioned in paragraph 6 of Mr Channon's covering note. The Commission has for some time been considering the possibility of "positive measures" to assist EC shipping, among which are included a special social security and personal taxation regime for seafarers. But no concrete proposals have yet been put forward. The subject is on the agenda of the meeting of the Council of Transport Ministers in June, and the Commission are expected to circulate a discussion paper. DTp are doubtful whether detailed proposals for a scheme of assistance will be put forward.

14. Paper IV describes access to merchant ships in crises and war. It reports generally satisfactory progress towards developing up to date requisitioning machinery, including agreements with major Flag of Convenience States, and extending war risks reinsurance. Although the paper does not say so explicitly, its thrust is to suggest that there is now less need to rely on the UK registered merchant fleet in wartime.

15. The attached annexes (all except F by the Revenue) give further information as follows:

Annex A: Comments, including an expanded line to take (if necessary) on the following points in Mr Channon's covering paper:

- international tax comparisons
- PAYE: administration of the 100% Foreign Earnings Deduction
- PAYE retrospection

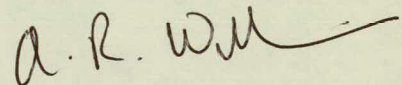
Annex B: Comments on Mr Channon's paper on offshore manning contracts

Annex C: Background note on the PAYE issue

Annex D: Background note on the taxation of seafarers

Annex E: A note on the tax treatment of grants and subsidies, and of other measures in the merchant shipping bill

Annex F: Discussion of the proposed contract scheme for vessels



A R WILLIAMS

**CHANCELLOR'S OWN PAPER****Key Points****PAYE**

- (i) Revenue's legal advice is that shipping companies should be operating PAYE.
- (ii) PAYE is about mechanics of collecting crews' UK tax liability - should not significantly affect companies' costs.
- (iii) Revenue cannot treat shipping companies differently <sup>from</sup> to other employers.
- (iv) Special exemption from PAYE obligations would be seen as condoning and encouraging seafarers' tax evasion - could be dangerously repercussive.

**Seafarers' tax liability**

- (i) Have considered possible changes which might indirectly reduce crew costs - all extremely unattractive.

**(ii) Exemption for seafarers**

- (a) contrary to present thrust of tax policy (reduce rates of tax while removing special exemptions).
- (b) unfair to other taxpayers' including Royal Navy (not based on taxable capacity).
- (c) difficult to target on ships particularly required for defence - and would apply to British crews on foreign ships also.
- (d) inefficient as means of reducing crew costs - GCBS recognise need for mechanism to ensure benefit accrues to companies not seafarers.

(iii) Additional relief for seamen - residence rules or 100 per cent foreign earnings deduction

(a) contrary to present thrust of tax policy.

(b) reversal of 1984 measures (withdrawal of other special reliefs for people working overseas).

(c) difficult to limit relaxation to seafarers.

(d) even less effective than exemption in reducing crew costs since title to relief uncertain until after the event.

(iv) Taxation changes all bad value for money.

"The case for alleviating the personal tax and social security burden on the industry should be further examined" [ *Mr Channon's recommendation (iV)* ]

[on tax]

Changes in the personal tax burden on seafarers would not offer a sensible solution to the problem of uncompetitive British crewing costs - such changes would

- be contrary to the general thrust of our tax policy
- act only very indirectly
- be very loosely targeted
- be bad value for money.

[on Social Security]

- National Insurance Contributions not a tax; they earn entitlement to benefits.
- NICs should not be 'selective employment tax', used to encourage employment in specific industries or regions.
- Government has always resisted Opposition proposals for concessionary NIC rates for regions.
- would certainly lead to pressure for similar concessions for other industries.
- would represent substantial erosion of Contributory principle. Mariners on same wage as other workers would pay less NICs for same benefits.

[on both]

- If further assistance to be given to shipping, clear this is not the best route. Seriously doubt any value in further examination.

"Should be prepared to announce that we are considering these further measures, to mitigate the likely reaction to the communication by the Inland Revenue of their decision of PAYE" [Mr Channon's recommendation (vi)]

- Revenue would not normally make general public announcement - would write to GCBS in general terms and to companies individually, because each case will be different.
- Unsuitable, therefore, for general public announcement - particularly given potential awkwardness of non-collection of tax for previous years.
- But agree that (even without retrospection) shipping companies bound to be displeased with outcome.
- Oppose any announcement of review of tax/social security changes. Regard as non-starter - would raise expectations, not only from shipping, but other industries under competitive pressure. And for shipping companies, ineffective in providing reassurance until positive measures announced.
- Also oppose announcement of work on contract scheme. Should not raise expectations before we are sure that proposal is worth pursuing. Besides, unlikely to mitigate greatly companies' reaction to PAYE decision.

[If colleagues insist that Revenue does not write to companies until work on contract scheme complete]

- Very short deadline for completion of this work essential - need to settle as soon as possible because continuing tax loss meanwhile so long as PAYE not operated.

## MR CHANNON'S COVERING PAPER

Assistance with crew costs (paras 6-12)i. International Tax ComparisonsFactual

a. Western nations with no special tax treatment for seafarers: Australia, Belgium, Canada, France, Germany, Ireland, Italy, Japan, New Zealand, Spain, USA. (Canada reported as considering special register - details not yet available).

b. Greece - special tax regime - seamen exempt - officers 5 per cent tax Denmark, Finland, Norway, Netherlands - special deductions or allowances - mainly high cost Scandinavian countries.

c. Recent reports that Denmark to exempt seamen from tax and Sweden to give income tax cuts to deep-sea seamen and subsidies to ship-owners to cover social security payments.

Line to take

Very difficult to make meaningful comparisons - many differences in terms of local income tax, social security taxes, benefits provided and structure of national income tax system - also varying levels of taxation - special relief more likely in high tax rate countries. General rules (eg our 100 per cent foreign earnings deduction which is not limited to seafarers) may give more favourable regime than special reliefs for seafarers. Fact that some other countries offer special reliefs not therefore sound basis for deciding our tax policy.



ii. PAYE: Administration of the 100 per cent Foreign Earnings Deduction (included in recommendation iii.)

Factual

Qualification for non-residence status or 100 per cent Foreign Earnings Deduction depends on actual absence from UK (not just intention) - impossible to establish title to relief in advance - concern that those who qualify may have tax deducted in-year and claim refund subsequently - claimed that new manning arrangements with longer journeys will result in more successful claims to relief.

Line to take

- a. Revenue aware of the point - happy to explore with companies how best to handle.
- b. When PAYE was operating, certain non-statutory arrangements with the companies enabled provisional relief to be given - need to explore with companies best way of alleviating this problem in new circumstances
- c. need for acceptable standard of evidence to afford protection against fraudulent or misleading claims to provisional relief in-year - need a fair degree of certainty to avoid possibility of seamen owing large tax arrears (a whole year's tax will be outstanding if provisional claim made and relief turns out not to be due).

iii. PAYE Retrospection (Included in recommendation iii.)

Factual

- a. Some companies crewed out some years ago - in the last two or three years some of the major companies have done this and stopped operating PAYE - Revenue normally

would require companies to pay tax they should have deducted - nevertheless in 1987 decided (and advised Department of Transport) that, in all circumstances, would not pursue past years.

b. Delay (because of discussions with Transport and more recently Ministerial discussions) means no PAYE deducted in 1987-88 also - having decided that companies should be operating PAYE, Revenue cannot recover from seamen direct - however difficult to insist on recovery from companies when delay is now on the Government side - need to make progress lest much of 1988-89 is also affected.

Line to take

Main aim to get PAYE operating for the future as soon as possible - Revenue have delayed pending conclusion of our discussions - no PAYE tax deducted in 1987-88 by companies concerned - nevertheless Revenue will not seek retrospection beyond start of this financial year. But this emphasises the need for early decision, enabling Revenue to get PAYE started again. Delay, to allow discussion by Ministers etc, during 1987-88 meant that a further whole year's tax has been permanently lost. Inland Revenue - and Treasury Ministers - accountable for that loss to PAC.

## MR CHANNON'S NOTE

## OFFSHORE MANNING CONTRACTS

1. The paper addresses the implications for shipping companies' offshore manning arrangements of Revenue decision to require PAYE operation (and the possible imposition of NI contribution liability).
2. The paper makes clear (paragraphs 4-5) that most of the savings in wage costs arise from changes not related to tax - but paying gross enables better control of labour costs - recent examples given of external changes which have added to direct employers' costs are both NIC changes (abolition of VEL; redundancy rebates).
3. The shipping companies are reported (paragraph 9) to have legal advice which contradicts Revenue's legal advice - this advice has not been seen yet by Revenue - companies will have opportunity to make their case.
4. It is suggested (paragraph 14(ii)) that seafarers may seek to renegotiate offshore packages if PAYE applied. Decision that company is deemed to be the employer for PAYE (under a special Regulation for that purpose) does not necessarily mean it is employer for any other purpose - companies should not need to compensate seamen for operating PAYE since tax liability has not changed.
5. If companies wish to continue not to operate PAYE, clearly either must use only foreign seafarers with no UK tax liability or employ British crews but change their management so that UK companies do not have general control and management of how the crews do their work. This would entail transferring the entire management of the ships - but not ownership - to an overseas subsidiary or overseas managers with no UK trading presence.

6. It is unlikely (paragraph 18) that a sight of the manning contract alone would give sufficient information to allow provisional relief for the foreign earnings deduction.

## SHIPPING : PAYE

1. The question at issue is whether, where shipping companies have contracted with offshore managing agencies to provide and pay crews for their ships, they remain legally responsible for applying PAYE to the crews' pay. The question is essentially one of the mechanics by which shipping crews pay tax; it does not in any way affect the amount of tax for which they are liable.

## BACKGROUND

2. In the past, UK shipping companies generally employed and paid their own crews and deducted PAYE tax from wages paid. In recent years growing numbers of these companies have contracted with manning agencies to engage, employ and pay crews for their ships. Most of these agencies have been based overseas or off-shore - some but not all in the Isle of Man.

3. Although many of the shipping companies also re-flagged their ships at the same time as they entered into crewing agency arrangements, the flag under which the ship sails is not relevant either to the question of the seaman's liability to tax or to the obligation to operate PAYE.

4. A number of major companies have made changes of this kind in recent years. The Revenue decided early in 1987 that, in view of the amount of tax involved, a fact-finding exercise should be mounted (with DHSS), with a view to achieving a consistent treatment of the shipping industry as a whole. It concentrated on the larger companies and most of the information sought was obtained by late summer. But because of anxieties expressed by Department of Transport, the Revenue's views on the position have not yet been put to the companies concerned.

## THE LEGAL POSITION

5. Collection of employees' tax is achieved by placing on employers an obligation to deduct tax under PAYE and to supply information about the employees' earnings. The statutory regulations define the employer for this purpose as:

- a. the person paying the employees; or
- b. any person who, although not the employees' immediate employer, has general control and management of the work being done by the employees.

6. Having examined the arrangements which some of the larger companies have made the Revenue concluded, on legal advice, that they should be operating PAYE. Under their arrangements with the agencies the shipping companies retain (as one would expect) the necessary measure of general control and management over the way the crews of their ships carry out their work to bring them within the scope of PAYE. (As the arrangements vary in detail from company to company it cannot be said categorically that all of them should be operating PAYE).

7. When earnings are liable to tax but the tax due cannot be collected through PAYE - because, for example, there is no employer within the UK jurisdiction who is liable to operate PAYE - the tax due has to be collected from the employees. But the Revenue are advised that there is no entitlement to collect tax from the employee himself in this way where strictly an "employer" should have operated PAYE. So, where a shipping company is liable to operate PAYE, that is strictly the only way in which the seafarer's tax liability can be collected. Under the current legislation, leaving the collection of this tax as a matter simply between individual seafarers and the Revenue is thus not an option. Such an approach would, in any event, be inherently inefficient and

in the absence of an obligation on the shipping companies to provide information there would inevitably be a significant and growing loss of tax.

#### SHIPPING COMPANIES POSITION

8. PAYE is not currently being operated where foreign and offshore crewing agencies are involved. The shipping industry is aware of the Inland Revenue's enquiries and is waiting to hear its conclusions. Some companies have told the Department of Transport that, despite having legal advice to the contrary, they would not fight a decision on the Revenue's part that PAYE should be operated but would instruct agencies not to employ UK seafarers. Given that the same amount of tax is legally due - whether it is collectible by PAYE or otherwise - the shipping companies do not have to "compensate" their employees for re-applying PAYE. They can hardly argue that not deducting tax gives them a competitive advantage because they are able to pay lower gross wages on the assumption that their employees will evade their tax liabilities.

9. Nor should operating PAYE involve a substantial administrative burden for the shipping companies. Independent studies have shown that for larger employers - particularly those with computerised payrolls - the administrative costs are largely offset - or more than offset - by the cash flow advantages of only remitting the tax due to the Revenue some time after it has been deducted from employees' pay.

10. It is generally acknowledged that a change to foreign crews would, even for companies which already use foreign and offshore manning agencies, provide a significant further saving in costs. Some of the shipping companies may be attracted by the prospect of this further saving in crew costs but be reluctant to incur themselves the opprobrium that such a change might attract. For them, the re-imposition of PAYE may be an opportunity to attribute the

change to government action. But there is certainly no guarantee that, even if PAYE were not operated in future, some of the companies would not take further steps to change to foreign flags, or to reduce their use of British crews, to achieve further cost savings.

#### CONCLUSION

11. The Revenue take the view that, on the information at present available, the shipping companies are under a legal obligation to operate PAYE, and that the Department has no option but to apply the law to shipping companies in the same way as it does to all other employers. Where PAYE should be operated by the shipping company, there is no other means of collecting the seafarers' income tax liability.



**TAXATION OF SEAFARERS**Present Rules

1. There are one or two special (technical) rules to cover the special circumstances of seafarers, but, apart from them, seafarers are taxed under the general rules applying to all United Kingdom taxpayers.

2. Very broadly, the position is

- If the seafarer is resident in the United Kingdom, he is taxable on all his earnings, subject to the general relief which applies to the overseas earnings of people who work for long periods abroad.
- If he is not resident he is only taxable on earnings for duties performed, or treated as performed, in the United Kingdom.

3. There are four main groups of rules which determine seafarers' tax liabilities

- the rules for determining whether or not someone is a United Kingdom resident
- the ordinary charge to income tax on earnings, which depends partly on the employee's residence status and partly on where his duties are performed
- the special rules for seafarers which determine which duties are treated as performed in the UK
- the special relief available to people chargeable to UK tax who work abroad for long periods.

Residence rules

4. The main question is whether the seafarer is resident in the United Kingdom or not; and that turns principally on the time he spends here.

5. He will be non-resident if

- he is physically absent from the UK for the whole of an income tax year
- all the duties of the employment are performed outside the UK and he does not visit the UK for more than 182 days in any year, or more than 90 days on average, during either a period of more than 3 years in which he is employed wholly abroad, or a period in which he is serving on a ship which does not visit the UK.

The income tax charge

6. The main charging rules provide that

- If the seafarer is resident in the United Kingdom, he is liable to tax on all his earnings, wherever the duties are performed.
- If he is not resident, he is only chargeable to tax on duties performed in the United Kingdom.

Which duties are treated as performed in the United Kingdom?

7. Since the resident seafarer is chargeable on his worldwide income, this question is only of importance for the non-resident.

8. For the non-resident, duties are regarded as performed in the United Kingdom where they are within UK territorial waters, or a designated Continental Shelf area (if they are

in connection with gas or oil activities), and on any voyage which does not extend to a foreign port.

#### Relief for long overseas absences

9. Although UK resident seafarers are chargeable on earnings from duties performed abroad, there are special rules (dating from the 1970s when income tax rates were much higher) which exempt certain overseas income earned during the course of long absences abroad. These rules were not introduced with seamen in mind, but they are among the main beneficiaries.

10. The basic rule is that there should be a period of continuous absence from the UK consisting of at least 365 consecutive days; but within that period up to 62 consecutive days can be spent in the United Kingdom. For the purposes of this relief, voyages to or from a foreign port are regarded as time spent abroad.

#### Travelling Expenses

11. Since 1986 special relief has been available for travelling expenses of UK resident employees who work overseas. This enables them to receive from their employer, tax-free, the cost of an unlimited number of journeys to and from the UK while working abroad.

#### What is the effect of these rules in practice?

12. Combinations of circumstances can vary widely, but broadly speaking seafarers probably fall into three main groups

a. Inland, port and coastal work, ferries and fishermen: since all, or a large part, of this work is done inside the 12 mile limit most seafarers in these trades would be chargeable to tax on their full earnings.

b. Deep sea crews working predominantly abroad: to the extent that they serve for long periods overseas, these people are likely to be exempt from United Kingdom tax. There are two possible routes

- if they are foreigners, or if they are away from the United Kingdom for a long time, they may be not resident under the rules in paragraph 5. In that event they will only be taxed on earnings for UK duties and will not be liable on earnings from voyages which do not touch on the UK.
- even if they remain resident so that they are liable on their worldwide income, they can qualify for the overseas earnings relief (paragraphs 9 and 10) if they are working overseas for long continuous periods.

c. Seamen working partly in the UK and partly overseas: these people will generally be liable to tax on the whole of their earnings because they are not overseas for long enough to qualify as being not resident (and therefore chargeable only on UK income) or to qualify for the overseas earnings relief for residents for long absences abroad.

Numbers involved

13. Rough orders of magnitude of the numbers currently in each of these three categories are as follows:-

a.	[redacted]	28,300	(500 Foreign)
b.	[redacted]	15,700	(5,200 Foreign)
c.	[redacted]	<u>1,500</u>	
total	[redacted]	<u>45,500</u>	



Royal Navy

14. These rules do not apply to the Royal Navy. Wherever they are, service personnel are regarded as performing their duties in the United Kingdom for tax purposes, and consequently are always taxable on their full pay.

Tax treatment of grants and subsidies

Grants, subsidies and other special payments made to traders out of public funds are normally either taxed as receipts of the trade or, if they are related to the cost of capital assets such as a ship, reduce the amount of the trader's expenditure qualifying for capital allowances. (The now discontinued Regional Development Grants and their equivalents are the sole exception to this general rule).

In consequence, compensation payments to shipowners for operating a vessel under the British flag (paragraph 17 of Mr Channon's paper of 19 April) would be taxable receipts in a shipper's hands.

Provision is also made in the current Merchant Shipping Bill for financial assistance to be paid towards

- i. costs of training merchant navy officers and ratings;
- ii. travel and other costs connected with crew relief.

Outright payments of the kind made to a trader would also be taxable receipts of the trade.

Other merchant shipping bill measure

The Bill also includes provision for the creation of a Merchant Navy Reserve and for the payment of an annual bounty to its members. The Department of Transport is aware that bounty payments made to members of existing reserve forces eg TAVR and RN reserve, in return for carrying out their obligations as reservists are taxable but that a special tax exemption exists which provides that bounties paid in consideration of reservists undertaking prescribed

training and reaching a specified level of training are not treated as income chargeable to tax. We understand that it was not originally planned that merchant navy reservists should have any training obligations - hence any bounty would be taxable. But this is currently under further consideration).

**CONTRACTING FOR VESSELS IN SHORT SUPPLY**

1. Mr Channon's main specific proposal not involving taxation or National Insurance is that a scheme to contract with owners of vessels in short supply should be worked up. As it is unclear whether the shortage of container ships will continue, and Mr Channon proposes to examine the possibility of dealing with the shortage of break bulk ships in other ways (eg by installing special gear on smaller container ships, or by containerising military supplies), the only ships affected by this proposal at present are product tankers of between 10,000 and 40,000 dwt. But there may be pressure to extend it to container ships in due course.

2. If something has to be done to secure shipping for defence needs, a proposal such as this one which is precisely targetted is preferable to generalised tax relief or subsidies. Moreover its costs will come under annual scrutiny in the Survey and hence are more likely to be controlled than the cost of tax relief. To that extent it is less unwelcome than Mr Channon's other proposals for assistance. But it would still be expensive, perhaps up to £50m a year.

3. The details of the proposal have still to be worked out. DTp's initial view is that shipping companies would be invited to tender to provide X UK registered product tankers for a subsidy of £Y per ship per year. X and Y would be specified by the company, perhaps with the constraint that a certain minimum number of ships had to be offered. The lowest tenders which together provided the required minimum number of ships (about 200) would be accepted. Mr Channon's paper suggests that the subsidy might have to be between £50,000 and £250,000 annually per ship. DTp consider that a subsidy of this sort should be sufficient not only to get flagged out UK owned vessels back on the UK register but also to persuade British companies to increase the number of the relevant type of vessels which they own (they expect the additional ships to be purchased second hand). It remains to be seen whether this is realistic.



4. The paper suggests that the subsidy would have to be offered to all product tankers, including those already UK registered. It would be possible to limit it to vessels not currently on the UK register but that would discriminate against companies still using the UK flag, and would encourage them to flag out.

5. You indicated at the time of the last shipping meeting that you might be prepared to consider a scheme of this sort. We consider that it would be difficult to <sup>oppose</sup> Mr Channon's proposal to do further work on it. But until this work have been done it would be premature for the Government to commit itself to proceeding further. An announcement at this stage would therefore be undesirable.

FROM: A M WHITE  
DATE: 3 MAY 1988

FINANCIAL SECRETARY

cc Chancellor → 12/2  
 Chief Secretary  
 Paymaster General  
 Economic Secretary  
 Sir P Middleton  
 Mr Anson  
 Mr Phillips  
 Mr Monck  
 Miss Peirson  
 Mr Burgner  
 Mr Bradley  
 Mr Waller  
 Mr Sharratt  
 Miss Huleatt-James  
 Mr Call  
 Mr Hyett T.Sol

*(see X)*  
 This proposal is agreed  
 when what we agreed  
 @ E(A). What we agreed  
 has to look at the possibilities  
 for a loan (detailed)  
 it is a good thing to  
 do. James's proposal  
 is quite good  
 but I think  
 we should  
 consider  
 the  
 possibility  
 of a  
 grant  
 also

JAMES MACKIE

We have received from Mr King's officials their revised proposals for James Mackie.

2. For convenience they have cast them in the form of a draft letter from Mr King to the Prime Minister as chairman of E(A) but Mr King will not write until we have been able to give his officials your reaction to his proposals.

The revised proposals

3. It is now proposed that, to meet E(A)'s opposition to equity investment by Government in the company, and in the absence of any adequate basis for security for a £20m loan (E(A)'s preferred approach), IDB assistance to the company should now take the form of:-

£ 7.5m of grant

£12.5m convertible loan stock

These amounts would be injected into the company, subject to strict performance targets, on the same pattern of phasing as proposed in E(A)(88)24.

*(not also available)*  
 15, 16, 17, 18, 19, 20, 21, 22, 23, 24, 25, 26, 27, 28, 29, 30, 31, 32, 33, 34, 35, 36, 37, 38, 39, 40, 41, 42, 43, 44, 45, 46, 47, 48, 49, 50, 51, 52, 53, 54, 55, 56, 57, 58, 59, 60, 61, 62, 63, 64, 65, 66, 67, 68, 69, 70, 71, 72, 73, 74, 75, 76, 77, 78, 79, 80, 81, 82, 83, 84, 85, 86, 87, 88, 89, 90, 91, 92, 93, 94, 95, 96, 97, 98, 99, 100, 101, 102, 103, 104, 105, 106, 107, 108, 109, 110, 111, 112, 113, 114, 115, 116, 117, 118, 119, 120, 121, 122, 123, 124, 125, 126, 127, 128, 129, 130, 131, 132, 133, 134, 135, 136, 137, 138, 139, 140, 141, 142, 143, 144, 145, 146, 147, 148, 149, 150, 151, 152, 153, 154, 155, 156, 157, 158, 159, 160, 161, 162, 163, 164, 165, 166, 167, 168, 169, 170, 171, 172, 173, 174, 175, 176, 177, 178, 179, 180, 181, 182, 183, 184, 185, 186, 187, 188, 189, 190, 191, 192, 193, 194, 195, 196, 197, 198, 199, 200, 201, 202, 203, 204, 205, 206, 207, 208, 209, 210, 211, 212, 213, 214, 215, 216, 217, 218, 219, 220, 221, 222, 223, 224, 225, 226, 227, 228, 229, 230, 231, 232, 233, 234, 235, 236, 237, 238, 239, 240, 241, 242, 243, 244, 245, 246, 247, 248, 249, 250, 251, 252, 253, 254, 255, 256, 257, 258, 259, 260, 261, 262, 263, 264, 265, 266, 267, 268, 269, 270, 271, 272, 273, 274, 275, 276, 277, 278, 279, 280, 281, 282, 283, 284, 285, 286, 287, 288, 289, 290, 291, 292, 293, 294, 295, 296, 297, 298, 299, 300

4. While the Government would be taking no equity stake in the company, the conversion rights of the loan stock would guard against any potential proceeds from a future sale of the company accruing solely to Mackies trustees. Conditions would be imposed on the package to secure necessary changes in top management and such other conditions as professional advisors might suggest.

5. Mr Kings officials are satisfied that the proposals would not infringe EC limits on state aid. But in view of the Foreign Secretary's comments (recorded in his Private Secretary's letter of 29 April) that the Commission will probably want to consider whether the proposed support is notifiable under Articles 92-3 of the Treaty, we have asked NI officials to clear their calculations with DTI, the FCO and ourselves. Articles 92-3 are concerned with support measures which threaten to distort competition between member states. The Foreign Secretary believes that difficulties with the Commission would be minimised if they were sounded out at an early stage about the proposals and in particular if they were advised of the political reasons which underpinned them. We have asked Northern Ireland officials to propose how this should be handled in their advice to Mr King

6. The proposal has a number of unsatisfactory features, most of which are reflected in the Northern Irish draft:-

(a) it does nothing to put the ownership of the company on a more commercial basis (the Northern Bank has made it clear that while it was prepared to take an equity stake alongside Government it is not prepared to do so alone);

(b) it is inconsistent with the assurance given to the PAC after De Lorean that in future industrial support would only be given to projects where a substantial part of the financial resources is provided by the private sector (it is argued that the exceptional 'rescue' nature of this project obviates that requirement - this is not a normal commercial proposal and assistance proposed on social and political grounds should not require a matching private sector contribution);

(c) while Mr King's officials are not aware of any historic liabilities (skeletons in the cupboard) that the Government would unwittingly assume in providing assistance they recognise that once the Government offers to sustain the company's continued trading in this way a future failure of the company could render the Government liable for all or some of its then current liabilities (at present the company owes just short of £1m to trade creditors and has a £9½m overdraft with the Northern Bank);

(d) accountability as well as control will be hampered by the decision to avoid any direct stake in the company and to rely on the conditions attached to the offer to secure management changes and improvement in performance;

(e) the package does nothing to encourage future private sector financial involvement in the development and ownership of Mackies.

7. As is clear from this catalogue the revised proposal put forward by Mr King's officials has no advantage over its predecessor other than simple compliance with E(A)'s decision to avoid taking an equity stake in Mackies.

8. Leaving the ownership of the business in the hands of the Mackies trustees appears to be a recipe for locking the Government into the business unless levels of profitability can be attained that would make it possible to find private sector buyers for the proposed loan stock. The downside risk is that the company would fail and, because Government had so clearly sustained the business by this assistance and become involved in its management, Government would be obliged to contribute to its then current liabilities. We are not certain whether this could extend to the redundancy costs for the proposed 700 workforce.

9. On this latter point of contingent liability, acceptance of Mr King's proposals would increase the risks of the Government being required to contribute towards the company's liabilities. It

is possible that his present £2m guarantee of part of Mackies overdraft means that he could be held liable to contribute towards the company's then current liabilities and his proposals could increase that liability. In addition, if the Government were to exercise any control over the company, it could be liable to contribute to the company's assets unless it could show that it has taken every possible step to minimise the potential loss to the company's creditors. The Government may therefore find itself having to be increasingly involved in the company's affairs in order to prevent this liability arising. This is not an outcome which our reading of the E(A) minutes leads us to believe that colleagues would welcome.

10. However, our own work has had us to the conclusion that, given the absence of private sector involvement in a rescue of Mackies, there is no way in which a package of assistance could be provided that would eliminate this risk.

11. Consequently in our view, Mr King's revised package should be rejected and Mackies be allowed to fail now, unless you feel that the social and political arguments advanced by Mr King are so compelling as to justify in the exceptional circumstances of Northern Ireland, such a sharp departure from Government economic policy.

12. If you feel such a departure is warranted then we will ask Northern Ireland officials to amend Mr King's letter to bring out more clearly the risks for colleagues and suggest a draft statement, perhaps by way of Written Answer to cover the position vis a vis the De Lorean assurance (para 6 b above). (One way of limiting risk which we propose should be attached as a condition to any grant and acquisition of loan stock is that the Government would not in any circumstances be responsible for the overdraft with the Northern Bank beyond the existing £2m guarantee. This would have to be made clear to the Bank which would have to give a formal acceptance of the position.)

13. If you do not, we will advise Mr King's officials that, although the revised proposals meet the E(A) requirement that a

CONFIDENTIAL

direct equity stake should be avoided, Treasury Ministers do not accept that the case for saving Mackies is so compelling as to justify the risk of Government becoming liable for Mackies current and prospective liabilities that these revised proposals entail.



A M WHITE

CONFIDENTIAL



10 DOWNING STREET  
LONDON SW1A 2AA

CH/EXCHEQUER	
REC.	05 MAY 1988 ✓ 15/5
ACTION	Mr A R Williams
COPIES TO	CST, FSI, Mr Anson
	Miss Peuson, Mr Robson
	Mr Culpin, Mr Rowlett
	Mr Fraser 1 R

4 May 1988

From the Private Secretary

*Handwritten notes:*  
 If [unclear] a  
 final battle on the  
 point to give the  
 conclusion @ X:  
 the PM is  
 in favour

*Handwritten notes:*  
 Strongly  
 of both tax relief  
 for [unclear] &  
 subsidies - M.

SHIPPING

The Prime Minister this morning held a meeting to discuss merchant shipping. This letter records the main points discussed; I should be grateful if you and copy recipients would ensure that it is circulated only to those with an operational need to see it.

The meeting considered your Secretary of State's minute of 19 April with four attached papers and the paper circulated by the Chancellor of the Exchequer on 30 March. Those present were the Foreign Secretary, the Chancellor of the Exchequer, the Home Secretary, the Defence Secretary, the Secretary of State for Trade and Industry, the Secretary of State for Transport, the Parliamentary Under-Secretary of State, DHSS (Mr. Portillo), and Mr. Richard Wilson and Mr. George Monger, Cabinet Office.

In discussion the following points were made:

- a. The decline of the merchant shipping fleet raised issues of great importance. Action by the Government was now clearly necessary to ensure that our wartime shipping requirements could be met. All other major seafaring nations provided assistance to their merchant shipping fleets in one form or another.
- b. In deciding what needed to be done the main consideration must be that seafarers were unusually mobile. They could readily go to work for foreign owners if they thought it was to their advantage. Because of this mobility, and the importance of our strategic needs, the case for measures of tax relief or extra expenditure to reduce the cost of employing crews was stronger than it would normally be.
- c. It was agreed that PAYE arrangements should not be applied in the Isle of Man retrospectively. For the future one option was not to apply PAYE to crews on ships flagged in the Isle of Man who had been recruited through Manx crewing agencies. But legislation would be needed:

it would be wrong to condone evasion.

- d. Other ways of providing tax relief for seafarers needed to be considered. There were some arguments against this approach. It risked being too indiscriminate and encouraging demands from other groups for similar concessions. But there were a number of arguments for it. Tax relief would avoid increasing public expenditure and was unlikely to raise difficulties under European Community rules. Greece, Norway, Denmark and the Netherlands all had special tax reliefs for seafarers. In discussion in the Community Council of Transport Ministers most Member States had supported fiscal action as the best way of reducing the cost of employing seafarers.
- e. There were two possibilities for tax concessions. One was to deem British seafarers crewing ships flagged in the Isle of Man or the Channel Islands to be domiciled in those islands. Another was to relax the rules governing their eligibility for the foreign earnings deduction. But there might be others. The need was to establish what system would best meet the Government's objectives with minimum danger of repercussions elsewhere.
- f. National insurance contributions for seafarers did not present the same difficulties as income tax; the Isle of Man authorities had established arrangements for collecting NICs and paying them over to the UK Exchequer.
- g. The alternative to tax relief was some form of subsidy. This could take the form of such payments to the shipping companies as would enable them to gross up seafarers' wages to offset their liability to tax and leave them no worse off than they were now. Another option was the contract with owners of vessels in short supply to secure their availability in time of war which the Transport Secretary had suggested. More work was needed on these options. But any system of subsidy would increase public expenditure: the examples of France and Germany suggested that the increase might have to be substantial. In principle an expenditure subsidy provided the opportunity for better targeting - on ships rather than seafarers - but it would need to apply to the pool of ships from which vessels would be made available in time of war and not just to those actually made available. It would need to be drawn up sufficiently generously to achieve its purpose.

X | The Prime Minister, summing up the discussion, said that the group were agreed that action must be taken to ensure that we could meet our wartime shipping requirements. This could take one of two forms: the introduction either of new tax reliefs for seafarers, or of a system of subsidies. No final decision could be taken until the options had been worked up in more detail. The Chancellor of the Exchequer and the Transport Secretary should now arrange for this to be done. All the options proposed at the meeting should be considered.



The work should be done urgently, so that it could be completed before any move on PAYE was announced or implemented.

I am copying this letter to the Private Secretaries of the Ministers at the meeting and to the others present.

PAUL GRAY

Roy Griffins, Esq.,  
Department of Transport.

SECRET

It was against this background that I asked my officials to explore with yours the scope for offsetting savings to meet in part the increased provision for the BS EFL which will be necessary. I had in mind a package involving equal contributions from DTI, Scottish Office and the Reserve to the agreed costs of disposal of Govan, and equal contributions from DTI and the Reserve to the agreed £7.6 million figure for advance factory building in Sunderland and the previously tabled costs of counselling, retraining and enterprise promotion in England. I am sorry that you were surprised to hear this. It seems to me that such an examination is always necessary, and that it is right similarly to look to Malcolm Rifkind for a contribution.

I am, however, mindful of the urgent need to reach agreement on the distribution of these costs and the problems which the need to reorder priorities to the extent necessary to find a significant contribution might cause you and Malcolm. I have therefore looked hard to see what might be the minimum I could accept. On this basis I would be prepared to accept all the agreed costs of disposal of Govan as a claim on the Reserve, together with costs of disposal or closure of other facilities which may be agreed between us, if you were willing to absorb the relatively modest costs in 1988-89 of remedial measures in England. I would need to look to Malcolm Rifkind similarly to fund the costs this year of any remedial measures in Scotland. The cost of any remedial measures in later years would be for discussion in the forthcoming Survey.

I hope that you will agree that this is a helpful basis for a quick agreement.

I am copying this letter to the Prime Minister, David Young, Malcolm Rifkind, Tom King and Nicholas Ridley, and to Sir Robin Butler.

Yours Ever,  
John

JOHN MAJOR

SECRET



*Handwritten initials: PUP*

cc:  
 Chancellor  
 FST  
 Sir Peter Middleton  
 Mr Anson  
 Mr Monck  
 Mr Burgner  
 Mr Moore  
 Miss Peirson  
 Mr Turnbull  
 Mr Waller  
 Mr A M White  
 Mrs Brown  
 Mr W Guy  
 Dr Baker  
 Mr A Hurst  
 Mr Sharrat  
 Mr N Williams  
 Mr Rutnam  
 Mr Cropper  
 Mr Tyrie  
 Mr Call

Treasury Chambers, Parliament Street, SW1P 3A

The Rt Hon Kenneth Clarke QC MP  
 Chancellor of the Duchy of Lancaster  
 Department of Trade and Industry  
 1 - 19 Victoria Street  
 London  
 SW1H 0ET

*Handwritten: Dear Ken,*

*Handwritten: 4<sup>th</sup>* May 1988

#### BRITISH SHIPBUILDERS

We spoke last night about your letter to Nigel Lawson of 18 April and I promised to consider afresh the extent to which I could entertain a claim on the Reserve for the various costs arising on British Shipbuilders and the extent to which a contribution should be found from the DTI budget.

I am aware that the settlement on the BS EFL which we reached in the last IFR was provisional, and of course I recognise that the costs of implementing your proposals for BS, which I fully support, will be substantial. I accept that you will need extra provision. But the fact is that you have not previously made a bid for any extra provision and I have not agreed to one.

Whilst I am quite prepared to accept the bulk of the costs of rationalising your policies as a charge to the Reserve, I cannot accept your proposition that all closure and disposal costs, as well as the remedial measures, should automatically be met in full from the Reserve.

You did not attempt to quantify the 1988-89 costs in your letter. But we know that they could easily be well in excess of £100 million if Govan were sold with a dowry of £75 million and all other BS facilities were closed or sold this year with dowries equal to the restimated closure costs.

This comes at a time when the Reserve for this year is already under pressure. Before April was out, claims on the Reserve of over £2½ billion had been made public. Severe restraint will be necessary for the remainder of the year if we are to convince our supporters and critics of our determination to maintain control over public spending.

FROM: J J HEYWOOD

DATE: 5 May 1988



PS/CHANCELLOR

cc	Mr Culpin	
	Mr Revolta	
	Mr McGivern	IR
	Mr Reed	IR
	PS/IR	

*I agree to  
action now:  
Whether  
Leeper, however,  
I will offer this  
relaxation in  
interest of X.*

BES: SHIPPING

The Financial Secretary has now read Mr Reed's submission of 26 April and your note of 27 April.

2. The Financial Secretary thinks that there is no logical case for retaining a £500,000 limit for owner-operated shipping companies, whilst having a £5m limit for ship-chartering. This distinction simply rests on the Revenue's view that ship chartering is the normal way of operating larger ships and therefore that a higher limit for owner-operated companies would be of no significant use in practice.

3. Nevertheless, the Financial Secretary is slightly disinclined to offer the GCBS a concession on this point, or to invite them, as Mr McGivern's letter would, to demonstrate the utility of an extension.

4. The Financial Secretary thinks that Mr McGivern should respond to the GCBS letter by clarifying the existing position and by saying that Ministers are not minded to introduce an extension because they do not believe an extension would have any effect.

5. If, despite this brush-off, the GCBS came back on the point, the Financial Secretary thinks that the Chancellor might consider introducing a BES relaxation as part of any package of measures which might emerge from his discussions with the Prime Minister on the wider problems of the shipping industry.

X

*q.m.*

JEREMY HEYWOOD  
Private Secretary



*mpw*

FROM: MISS M P WALLACE

DATE: 5 May 1988

PS/FINANCIAL SECRETARY

cc Chief Secretary  
 Paymaster General  
 Economic Secretary  
 Sir P Middleton  
 Mr Anson  
 Mr Phillips  
 Mr Monck  
 Miss Peirson  
 Mr Burgner  
 Mr Bradley AM  
 Mr Waller ← *Mr White*  
 Mr Sharratt  
 Miss Huleatt-James  
 Mr Call  
 Mr Hyett T.Sol

**JAMES MACKIE**

The Chancellor has seen Mr White's minute of 3 May. He has commented that this proposal is not what was agreed at E(A). There it was agreed that we should look into the possibility of a secured loan - i.e. a floating charge on the company's assets - whereas this proposal is part grant and part unsecured loan. At E(A), it was also envisaged that the Northern Bank would stay in with an equity stake, although this was not noted in the minutes.

*mpw.*

**MOIRA WALLACE**

may6

CONFIDENTIAL

*pps pl (my min  
of today)  
etc.)*

*my*

FROM: A M WHITE  
DATE: 5 MAY 1988

FINANCIAL SECRETARY

cc Chancellor  
Chief Secretary  
Paymaster General  
Economic Secretary  
Sir P Middleton  
Mr Anson  
Mr Phillips  
Mr Monck  
Miss Peirson  
Mr Burgner  
Mr Bradley  
Mr Waller  
Mr Sharratt  
Miss Huleatt-James  
Mr Call  
Mr Hyett T.Sol

*✓*

JAMES MACKIE

Following your meeting this afternoon I spoke further with Mr King's officials.

2. They confirmed that there are both fixed and floating charges on the company's assets held by the Northern Bank as security for the £7½ million of Mackie's overdraft not covered by the Secretary of State's existing guarantees.

3. Their firm impression is that there would be no chance of the Northern Bank agreeing to dilute its security at all, although they have not put the question point blank to the bank. I have asked them to do so, and to report the bank's response to me tomorrow.

4. In further discussion they said that IDB's own tentative valuation of the company's assets is £10-£12m on the basis of a forced sale - almost certainly a 'break up' valuation. There was thus a theoretical element of uncommitted security that could be held against at least the first tranche of the proposed package of assistance. However, their legal advice was that should the Government seek this security for a loan it could well be held to

CONFIDENTIAL

be creating a fraudulent preference over the company's unsecured creditors. They consequently would not recommend this course.

5. In my view, subject to Mr Hyett's confirmation on this 'fraudulent preference' point, the quality of the security would be so low that it would not warrant further compromising the Government's position in the case of an eventual collapse of the company by this additional complication.

6. There is no satisfactory means of supporting Mackies and Mr King's present proposals, subject to the additional qualifications proposed in my submission of 3 May would seem the least unsatisfactory way forward, given colleagues wish to sustain Mackies.

7. If you agree, you may wish to speak to Mr Viggers outlining your concern over the risks inherent in this approach, and suggesting that his officials clear with us the draft of a minute from Mr King to colleagues reporting his failure to meet the E(A) minute and seeking acceptance of his revised proposals, together with the text of a proposed statement (which would need to address the De Laurean assurance point).



A M WHITE

CONFIDENTIAL



FROM: J M G TAYLOR

DATE: 6 May 1988

*pmf*

MR A R WILLIAMS

cc Chief Secretary  
Financial Secretary  
Mr Anson  
Miss Peirson  
Mr Robson  
Mr Culpin  
Mr Revolta  
  
Mr Fraser IR

**SHIPPING**

The Chancellor has seen Mr Gray's (No.10) record of the Prime Minister's meeting on 4 May.

2. He has commented that it required a fierce battle to get the conclusion that we should use either tax reliefs or subsidies to ensure that we could meet our war time shipping requirements. The Prime Minister is strongly in favour of both tax reliefs for seafarers and subsidies.

*JMG*

J M G TAYLOR



CONFIDENTIAL

APS/CHANCELLOR

FROM: J J HEYWOOD

DATE: 6 May 1988

cc PS/Chief Secretary  
 Sir P Middleton  
 Mr Anson  
 Mr Monck  
 Mr Phillips  
 Miss Peirson  
 Mr Burgner  
 Mr A White  
 Mr Call

pl let me have

minutes  
of E(A) on

25/4

J Heywood

m.

Thanks  
NAB

JAMES MACKIE

Further to your minute of 5 May and to Mr White's minutes of 3 and 5 May, the Financial Secretary has now spoken to Mr Viggers.

2. Mr Viggers pressed the Financial Secretary to agree that the proposal contained in Mr White's minute of 3 May was the best available, and to agree that Mr King could now send a "joint memorandum" to the Prime Minister outlining the scheme and carrying Treasury endorsement of it.

3. The Financial Secretary said that he had not seen the draft memorandum and could, therefore, not agree to what was proposed. The Financial Secretary said that any memorandum would need to be quite explicit about three issues:

- (i) The proposed scheme did not meet E(A)'s remit in that the proposed financial assistance was not in the form of a secured loan;
- (ii) The scheme was inconsistent with the assurance given to the PAC after DeLorean that in future industrial support would only be given to projects where a substantial part of the financial resources is provided by the private sector;

CONFIDENTIAL

(iii) The scheme appeared to leave the Government liable not only for all or some of Mackies' current liabilities but also for any historic liabilities.

4. The Financial Secretary said that if the memorandum covered all these points in due detail, he would consider whether it would be appropriate for him to put his name to it. The next step was therefore for officials to work up a memorandum for Ministers' consideration.

5. Mr Viggers made two comments on the points raised by the Financial Secretary:

(i) The Northern Bank was not prepared to see their security diluted and nor were they prepared to take an equity stake. Given this, it was simply not possible for the Government to lend on security - in liquidation the total value of Mackies' assets would be £9½-11m, of which £7½m would go to the Bank. Moreover, the fact that Northern Bank would get their money back in full even if the Government allowed Mackies to close meant that we had no bargaining leverage in seeking to persuade the bank to allow its security to be diluted.

2  
-  
(ii) The assurance given to the PAC could be set aside if Ministers decided collectively that special political and social factors justified Government support without a matching private sector contribution.

6. In the light of (i), the Financial Secretary believes there is no possibility of fulfilling E(A)'s remit. He will consider the question of a joint memorandum when officials have worked on this with the lawyers. (Mr White has had a first discussion with N.I.O. officials, who are now producing a draft reflecting Treasury concerns for discussion next week).

J.H.

JEREMY HEYWOOD  
Private Secretary

The Rt. Hon. Kenneth Clarke QC MP  
Chancellor of the Duchy of Lancaster and  
Minister of Trade and Industry

Rt Hon John Major MP  
Chief Secretary  
HM Treasury  
Parliament Street  
LONDON  
SW1P 3AG

*Put in folder for E(A) [unclear]*

Department of  
Trade and Industry

1-19 Victoria Street  
London SW1H 0ET

Switchboard  
01-215 7877

Telex 8811074/5 DTHQ G  
Fax 01-222 2629

Direct line 215 5147  
Our ref  
Your ref  
Date 6 May 1988

CHIEF SECRETARY	
REC.	- 9 MAY 1988
ACTION	<i>Mr. [unclear]</i>
COPIES TO	<i>Mr. FST [unclear] Mr. [unclear]</i>
	<i>Mr. [unclear] Mr. [unclear] Mr. [unclear]</i>
	<i>Mr. [unclear] Mr. [unclear] Miss [unclear]</i>
	<i>Mr. [unclear] Mr. [unclear] Mr. [unclear]</i>
	<i>Dr. [unclear] Mr. [unclear] Mr. [unclear]</i>
	<i>Mr. [unclear] Mr. [unclear] Mr. [unclear]</i>
	<i>Mr. [unclear] Mr. [unclear]</i>

Dear Chief Secretary,

**BRITISH SHIPBUILDERS**

Thank you for your letter of 4 May.

I welcome your acceptance that the costs of closure of British Shipbuilders, including the costs of disposal of Govan and other disposal and closure costs, should be met by the Reserve.

As I said when we met, in view of pressures on the Reserve this year, I am prepared to take on the costs in 1988-89 of advance factory provision in the context of decisions on closure. Given the reduced scale of advance factory building agreed by colleagues, and the time it will take to get a £7½ million programme under way, I would not expect to be able to spend more than £2-3 million in 1988-89. On the understanding that these costs will be carried through the proposed BS Enterprise Company, the later years' costs will need to be considered as part of BS's overall finances in the Investment and Financing Review.



the department for Enterprise

Your letter however proposes that I should also pick up the current year costs of the enterprise package in England. This was not part of my proposal. These costs are intimately associated with the closure decision itself, and bear little relation to my Department's main programmes. I should therefore like to go back to the position I thought we had agreed, that the Exchequer and my Department should share the indirect costs in England in 1988-89, with DTI accepting the factory costs and the Reserve the rest.

I am not of course able to speak for Malcolm Rifkind in respect of Scottish closure costs.

I am sending copies of this letter to the Prime Minister, David Young, Malcolm Rifkind, Tom King and Nicholas Ridley, and to Sir Robin Butler.

Your sincerely,

Peter Smith

PS/COT tells me there is no truth in this whatsoever!

PP

KENNETH CLARKE

(Approved by the Chancellor and signed in his absence)



Inland Revenue

Policy Division  
Somerset House

*As soon as PS  
has consulted  
I will take to discuss  
2. Altho I am of  
course not prepared  
to, what we propose  
of extra 28 x 29 relaxed  
was fine 80% of  
P.S. The original in para 6  
an subsequent  
had discussed  
practical  
v. little  
what  
I do not  
how X can  
the  
let  
from  
out  
for  
PS*

FROM: P LEWIS  
EXT: 6489  
DATE: 6 MAY 1988

FINANCIAL SECRETARY

TAXATION OF SEAFARERS

1. I understand that you would like urgent advice on two proposals which your Private Secretary told me the Chancellor was asked to consider at the Prime Minister's meeting on 4 May

- that crews of ships registered in the Isle of Man should be deemed to be not domiciled in the UK for tax purposes
- that the period which can be spent in the UK without prejudicing a claim to the 100% foreign earnings deduction should be increased from 62 days to 90 days

cc Chancellor  
 Chief Secretary  
 Paymaster General  
 Economic Secretary  
 Sir P Middleton  
 Mr Scholar  
 Mrs Case  
 Mr Revolta  
 Ms Sinclair  
 Mr A R Williams  
 Mr Cropper  
 Mr Tyrie  
 Mr Call  
 Mr C Jenkins (OPC)

Chairman  
 Mr Isaac  
 Mr Beighton  
 Mr Lewis  
 Miss Rhodes  
 Mr R H Allen  
 Mr O'Brien  
 Mr Fraser  
 Mr Alpe  
 Mr I Stewart  
 Mr K Allen  
 Mrs Williams  
 PS/IR

A: TAX RELIEF FOR CREWS OF SHIPS REGISTERED IN THE ISLE OF MAN

2. This proposal has been framed in terms of deeming crewmen to be "not domiciled" in the UK, but "not resident" may have been intended since residence is far more important for determining income tax liability than domicile - being "non-domiciled" would be of little advantage to the typical British seaman with his home and family here. In brief, the position is that being non-domiciled would mean that in certain limited circumstances a seaman would only be taxed on the remittance basis - but if he lives here he will probably have to remit all, or virtually all, of his earnings in any event. In contrast, if he is non-resident he will be liable only on earnings from duties which for tax purposes are treated as performed in the UK.

3. If the intention is to exempt the overseas earnings of UK seamen on IOM registered ships from UK income tax, we think it is better to go for an explicit exemption rather than to try to achieve that result indirectly through a deemed non-residence rule. There are three main reasons

- the seamen concerned will often be very clearly resident in the UK by reference to the normal rules, so it would seem highly artificial deeming them not to be
- you are considering shortly launching a consultative document on residence which is intended to simplify and rationalise the existing hotch-potch of rules. Simultaneously introducing an arbitrary deeming provision would sit uneasily with those proposals \*
- more important, residence is a concept which essentially works by reference to the whole tax year.

---

\* As they stand at present, these proposals might provide some help with the current problems since they would allow a seaman to spend rather longer in the UK without becoming resident. But as the possible residence changes are at an early stage, it seems difficult to put much weight on them in this context.

In contrast, a seaman may be employed for a shorter or longer period on an IOM registered ship, and employment on such ships may be interspersed with periods of unemployment or work ashore or on ships registered elsewhere. So some kind of rule would be necessary which made the seaman non resident when he had served a specified minimum number of days in the year on an IOM ship. Such a rule would be fairly complex (it would have to cater for leave periods, periods between ships etc) arbitrary, and uncertain in its effect until a seaman had logged up the necessary number of days.

4. It seems better, therefore, to go for the proposition that earnings relating to periods of duty on an IOM registered ship should be exempt from tax.

5. If one stopped there all earnings by UK seamen on IOM registered ships would be exempt, whether they were foreign or UK voyages. So people working on, for example, IOM registered ferries operating in home waters would be exempt. The relief would thus go unnecessarily wide since there is no concern about the availability of ships which operate only in home waters. A new relief should only run for earnings from overseas voyages.

6. We suggest, therefore, that the proposal should be restated as an exemption for the earnings of seafarers from overseas voyages of IOM registered ships.

#### Main features of the relief

7. A relief on the lines of paragraph 6 entails four crucial definitions "earnings", "seafarers", "overseas voyages" and "ships".

#### a. Earnings

This is the most straightforward. It would be necessary to identify the pay applicable to the "exempt" voyage, taking account of various factors, for example leave pay. There

are provisions in the foreign earnings deduction provisions which could probably be adopted or modified for this purpose.

b. Seafarers

It would be necessary to decide whether or not you wanted to exempt everyone employed on a ship. At first sight it would look odd to exempt for defence reasons entertainers, shop keepers, waiters, stewards, cooks etc - the people who entertain and look after passengers, and whose jobs are very similar to the corresponding on-shore occupations. But this might become a less significant problem if you were to exclude from qualification certain types of ship such as cruise vessels (see d. below).

c. Oversea voyages

We assume the intention here would be to focus on the deep-sea trades which have defence implications.

There is no problem with "cross-trading" - voyages which both begin and end outside the UK. They should clearly be eligible. So too should voyages which begin or end in the UK and which are to or from a foreign port. This is the approach adopted in the foreign earnings deduction legislation in the definition of overseas duties. But it would not be sufficient here because it would let in all international ferries and cross-channel traffic, and would encourage coastal traffic and fishermen to call at the nearest Irish or French port to qualify for exemption on the earnings from the whole of the voyage. So we would need to explore with Department of Transport how best to limit the overseas voyages which qualified to "deep sea" voyages. One possibility would be only to allow voyages over a certain distance to qualify.



d. Ships

As we understand it, there is concern about only three categories of ships - product tankers, container ships, and large general cargo vessels; and only in the case of the product tankers is there need for immediate action. The relief could therefore be confined to specific categories of ships. This would itself greatly help with some of the other presentational/definitional problems. For example, all ferries would be excluded, even those making long overnight voyages. And excluding cruise ships and ferries would automatically exclude the less seaman-like jobs noted in b. above.

Position of UK registered ships

8. We assume that the proposal has been couched in terms of IOM registered ships because the IOM register offers - after the UK register - defence advantages. But if the relief applies only to IOM registered ships and not to UK registered ships also there would be a further incentive for ships to be moved away from the UK register and on to the IOM register. If it were wished to avoid that effect, the relief, as described above, could be extended also to ships on the UK register. It would seem perverse not to do this. It would be for consideration whether the UK dependent territory registers should also be included.

European community aspects

9. The relief would apply to all EC nationals resident in the UK, and so would not be discriminatory in that sense. But it would be linked solely to the IOM/UK registers and so could be said to discriminate in favour of them. If Ministers wished to proceed we would need examine the EC aspects carefully. The preliminary view from our international group is that such a proposal could be vulnerable to attack under Article 92 of the Treaty of Rome; at the very least the EC would want to probe it carefully.

Operational

10. We see no particular operational problems with a relief of this kind. Where the shipping companies concerned are (or will be) operating PAYE we could make arrangements to ensure that wages relating to overseas duties on IOM/UK registered ships were paid gross. In most cases it should be reasonably clear to the shipping companies whether duties were performed overseas or in the UK; but where there was a mixture with a significant proportion of UK duties, we might need to ask the shipping companies to deduct tax and deal with any exempt income by repayment after the end of the tax year. This is something we might need to discuss with the shipping companies in the light of their individual pattern of operations. We would also need to consider further the collection implications for NICs since the exemption would cover income tax but not contributions.

Cost

11. There are two bases on which theoretically the cost of a relief of this kind could be calculated. First, by reference to the tax seamen ought to be paying now; and second by reference to the tax they are actually paying given the non-operation of PAYE by some shipping companies (including most of those with IOM registered ships which are operated overseas).

12. In practice, we have insufficient information to produce a reliable costing on either basis. But we think the broad orders of magnitude might be some £10-20m if seamen were paying their proper tax now; but something much less in reality.

Legislation: Timing and Content

13. There would clearly be a problem with the timing of legislation. With the Chief Secretary aiming to have the Bill out of Committee well before the end of June and a Ministerial decision on the outline of the relief possibly still some weeks off, time is getting very short for working up a full-blown Finance Bill provision, and consulting with Transport and GCBS on

the details. (This would be the sort of provision on which consultation seems essential.) This suggests two other possibilities.

14. First, there could be an announcement, with legislation promised for next year. Even if the legislation were backdated to 6 April 1988, that might not be very satisfactory since given that it would inevitably be fairly technical (and probably could not be implemented in advance), seafarers and their representatives might not be prepared to go very far in negotiating lower wage rates until all the details of the relief were on the statute book.

15. An alternative - subject to consultation with Parliamentary Counsel - would be a much briefer enabling provision, leaving much of the difficult but crucial detail - such as the definition of overseas voyages and qualifying ships - to be filled in by Regulations on which we could consult the industry over a more helpful timescale. There would in any event be a considerable advantage in being able to alter definitions by Regulation, since defence needs could well change, sometimes fairly quickly.

#### Evaluation

16. We look first at tax policy; and then at the likely effectiveness of this measure in relation to shipping policy objectives.

##### a. Tax Policy

17. The proposal clearly makes little or no sense in relation to tax policy. The taxable capacity of seamen is no different from that of other taxpayers with the same income. Previous policy has been to reduce the special reliefs for overseas earnings in the light of falling tax rates. The introduction of a new special exemption following a Budget in which there were large across-the-board tax reductions, and further tax shelters and reliefs were swept away, would clearly be a retrograde step in terms of broad fiscal policy. Nevertheless, the Government has

always made it clear that it would be prepared to introduce special reliefs when circumstances warranted it (eg BES, PEPs etc) and an argument based on naval and defence needs would, no doubt, receive a warm reception in some quarters (if the current strike does not damage the image of seamen too much. Clearly Ministers would need to consider carefully the handling and announcement of any changes during, or in the aftermath of, the strike).

18. Even so, there would be some ripples. The taxation of air crew and seamen has usually (for obvious reasons) gone hand-in-hand and there could be some pressure from the aviation industry for some comparable relief. There would inevitably be pay and taxation comparisons with Royal Navy personnel. And, to the extent that the root of the problem is third-world labour costs rather than immediate defence needs, there could be pleas for similar help from other hard pressed industries which could mount a colourable case that their continuation was "in the national interest".

b. Shipping policy

19. In these paragraphs we comment briefly on how effective such a relief might be in achieving the Government's shipping objectives, as we understand them.

20. There are three advantages to this approach

- it would be limited to ships on the IOM/UK registry (if the EC hurdles can be overcome), which are the vessels important for defence purposes, and would not give relief to UK seafarers serving on ships registered on other overseas registers which are of more questionable value for defence purposes
- if, as we suggest, the relief is limited to specific categories of ship which are important for defence purposes, it would be quite well targeted

- because the relief would be linked to pay for an overseas voyage, it should be reasonably clear in most cases in advance that relief would be due, and is thus somewhat more likely to be reflected in pay rates than changes either to the residence rules or the 100% foreign earnings deduction where title to relief can only be finally determined after the end of the tax year.

21. As against that, it suffers from some disadvantages

- the extent to which tax exemptions for seafarers would be reflected in lower operating costs for shipping companies - and that, as we understand it, is the whole object of this exercise - would be entirely a matter of negotiation between the two parties. Given that the tax liabilities of seafarers will vary widely individually, whereas shipping companies will want to set uniform wage rates for particular grades, a significant part of the cost of tax relief will probably not be reflected in lower operating costs. (In discussing the possibility of tax reliefs for seafarers the GCBS have always stressed the need for some "mechanism" to ensure that the benefit accrued to the shipping companies, not the seafarers)
- a tax exemption is inevitably a blunt instrument. The average rate of tax for a married man on average male earnings is about 17%. If that is an insufficient subsidy to keep the scarcity categories of vessel on the specified registers, the change would be ineffective. If, on the other hand, the subsidy is higher than necessary then there is to that extent wasted expenditure.
- as with any tax relief of this kind (as distinct from a contractual subsidy) you might end up giving the tax relief on existing ships without getting any new ones. There would be no guarantee of additionality

- there would be likely to be distortions in the labour market. That might be acceptable to the extent that crews were encouraged to work on "exempt" ships. But other, perhaps commercially marginal, companies could find their position worsened if they had to offer more pay to compete with "exempt" work.

22. All this assumes that the introduction of a new tax relief on these lines would be perceived as an additional benefit by the shipping companies. But the reality seems to be - we cannot be precise in the absence of information now that PAYE is not operating - that a large proportion of the seafarers concerned are already enjoying a de facto tax exemption. To the extent that shipping companies have already managed to reflect this in somewhat lower wage rates a new tax exemption would merely regularise the present position, and would not offer any further encouragement to them to continue in shipping activities which are financially unrewarding but necessary for defence purposes. If, on the other hand, shipping companies have not already managed to negotiate lower wage rates it is perhaps doubtful whether merely regularising the present relief would enable them to do so. Either way, a new tax relief may not be perceived by the shipping companies as much, if any, improvement on the present position in which they are not operating PAYE. Indeed, to the extent that a new relief was narrowly targeted on certain registries, certain types of ships and certain voyages, it would clearly be less extensive than the present unrestricted de facto PAYE exemption.

#### Conclusion on tax exemption

23. While we would clearly need to do further work on the details, our preliminary view is that a relief on the lines outlined above is practical both from a legislative and operational point of view. (But it is likely that the EC may be as hostile to a discriminatory tax relief as they would be to a subsidy).

24. Given the likely timetable for Ministerial discussions and the need for consultation with the shipping industry to ensure that a new relief does what is intended, it could probably only be introduced in the 1989 Finance Bill in the form of an enabling provision.

25. It would sit unhappily with the general thrust of tax policy and could generate other claims for special treatment. But the defence considerations are important, and there are recent precedents for the introduction of special reliefs where there was thought to be a sufficient justification for them.

26. As for meeting shipping policy objectives, there are grounds for thinking it might be largely ineffective. Some consultation with shipping interests in advance of any decision seems essential to establish whether or not the proposal would have any real impact on current problems - or would be perceived as leaving them to some extent in a worse position than they are now.

B: RELAXATION OF THE RULES FOR THE 100% FOREIGN EARNINGS DEDUCTION

27. The present rules provide an exemption from UK tax where the duties of an employment are performed wholly or partly abroad and there is a qualifying period of at least 365 days. The qualifying period has to consist essentially of days outside the United Kingdom, but where there are spells in the United Kingdom between periods when duties are performed overseas they can still count towards a qualifying period provided that they are not longer than 62 days or 1/6th of the total period.

28. The proposal is that the maximum 62 days allowed in the United Kingdom should be increased to 90.

29. If that limit were to be increased, it would probably be sensible to increase the fraction from 1/6th to 1/4 also since the three limits have always been regarded as linked (62 days is approximately 1/6th of a year; and 90 days is approximately 1/4 of a year).

30. In some respects the fraction is more important than the maximum permitted absence, since the fraction comes into play whenever a seaman is in the UK between relatively short trips abroad. Thus, if the pattern is 40 days away, 20 days in the UK and then 30 days away making a total of 90 days in all, that could not at present count towards an eventual qualifying period of 365 days because  $1/6$ th of 90 is 15 days, which is less than the 20 days spent in the UK. If the fraction were increased to  $1/4$ , however, the whole 90 days could count towards a qualifying period since the period in the UK would be less than a quarter of the total period.

31. A clause along these lines, applying only to seamen, was put down last year by Sir William Clark, but was not debated. There were a considerable number of representations from seamen when the 25% relief for foreign earnings was withdrawn in the Finance Act 1984, and when withdrawal became effective, but there have been few representations recently.

#### Operational

32. A change of this kind would present no particular operational difficulty, and could be made effective from 6 April last.

33. As you know, we have undertaken to consider with the shipping companies, when PAYE is introduced, whether it is possible in certain circumstances to agree that the 100% foreign earnings deduction is likely to be due, and to authorise the shipping companies to make payments gross rather than under deduction of tax. (The relief has in the past almost invariably been given in arrear by repayment, since title to the relief can only be finally established after the event, when a qualifying period has emerged). If the rules were relaxed in this way, it would enable us to agree in more cases that relief was likely to be due, and thus to authorise payment gross. But there will, of course, always be awkward cases on the border line, wherever it is drawn.



Cost

34. We have no means of costing this proposal because we do not know how many seamen would be in the band effected by a relaxation of this kind - or how many would seek to change their voyage arrangements so that they fell within the new conditions for relief. But since a clause to this effect was tabled last year - we assume on behalf of the GCBS - it would presumably at least meet the shipping industry's minimum objectives with regard to the taxation of seafarers. That suggests that a fair number of seamen might be able to benefit.

Legislation/timing

35. The legislation required for this change would be quite short, and could be got ready in time for this year's Finance Bill.

Evaluation

36. This proposal also does not fit in well with the general thrust of tax policy. It would represent an expansion of a special relief for working overseas when previous policy has been to reduce such special reliefs and exemptions as tax rates fall. And the continuation of this relief - at least in its present form - may need to be reviewed in a world of lower tax rates and more generous residence rules.

37. However, it would clearly be easier to swallow than the previous proposal since it could be presented as an easing of an existing relief rather than a totally new kind of relief. Since, however, it would be restricted to seamen, it would also be likely to generate claims for similar treatment from other groups. Arguably that reaction might be stronger if you extend on a limited basis an existing relief which other people already enjoy than if you introduced a separate special relief for seamen.

38. So far as shipping policy objectives are concerned, this proposal suffers from much the same defects as the other, in particular the lack of any mechanism to ensure that the seafarers' tax reductions accrue to the benefit of the shipping companies. The targeting would be worse because the extra relief would apply to UK seamen on any kind of ships, on any register. It seems likely to be even less effective than the other proposal, in part because it is less generous (it applies only to long continuous absences overseas instead of all overseas duties) and it will be less certain in advance that relief will be due. And as with the other proposal, it is uncertain how far shipping companies would regard such a change as merely regularising the existing position as opposed to giving them additional assistance in their present difficulties. And again, to the extent that seamen who are now escaping PAYE do not qualify for the new relief - we cannot say how often that might happen - the shipping companies will see themselves as in a worse position after the reintroduction of PAYE.

#### Conclusion

39. This proposal also looks unattractive in tax policy terms and likely to be both ineffective and badly targeted in meeting shipping policy objectives.

40. But as compared with the other proposal it may be less repercussive, and would require only a short piece of legislation which could be got ready for this year's Finance Bill.

41. We have serious doubts about whether either really addresses the shipping industry/defence problem. But if a tax measure of some kind to offset in part the reintroduction of PAYE is considered essential in a shipping package there seem to be less difficulties and disadvantages in the second than in the first.

Lisa Miles

for P LEWIS

RESTRICTED



FROM: J M G TAYLOR

DATE: 6 May 1988

*[Handwritten signature]*

PS/FINANCIAL SECRETARY

cc Mr Culpin  
Mr Revolta

Mr McGivern IR  
Mr Reed IR  
PS/IR

**BES: SHIPPING**

The Chancellor has seen your minute of 5 May.

2. He agrees that with the Financial Secretary's conclusion that we should make no concession now. Whatever happens, however, he will offer this relaxation in the context of the discussions with the Prime Minister about the wider problems of the shipping industry.

*[Handwritten initials]*

J M G TAYLOR


 11/5  
 FROM: J M G TAYLOR

DATE: 9 May 1988

PS/FINANCIAL SECRETARY

 cc PS/Chief Secretary  
 PS/Paymaster General  
 PS/Economic Secretary  
 Sir P Middleton  
 Mr Scholar  
 Mrs Case  
 Mr Revolta  
 Miss Sinclair  
 Mr A R Williams  
 Mr Cropper  
 Mr Tyrie  
 Mr Call  
 Mr C Jenkins (OPC)  
 Mr Battishill  
 Mr Isaac  
 Mr Beighton  
 Mr Lewis  
 PS/IR
**TAXATION OF SEAFARERS**

The Chancellor has seen Mr Lewis' submission of 6 May. He would like to discuss this bilaterally with the Financial Secretary.

2. The Chancellor has asked what would be the cost of extending the relaxation of the rules for the 100 per cent foreign earnings deductions, outlined in paragraphs 28 and 29, to everyone and not just seafarers. (He is, of course, not proposing this).

3. He has commented that the proposal in paragraph 6, i.e. an exemption for the earnings of seafarers from overseas voyages of IOM registered ships, as subsequently refined, would presumably in practice cost very little indeed. Nevertheless, he does not understand how it can be true that the proposal would be perceived as leaving shipping interests in a worse position than they are now (paragraph 26) given that we intend to enforce PAYE.

4. I should be grateful for Mr Lewis' advice on these points.

J M G TAYLOR

SECRET

FROM: W GUY  
 DATE: 9 May 1988

- 9/5  
 1. MRS BROWN  
 2. CHANCELLOR

cc CST  
 FST  
 EST  
 Sir P Middleton  
 Mr Anson  
 Mr Monck  
 Mr Burgner  
 Mr Moore  
 Miss Peirson  
 Mr Waller  
 Mr A M White  
 Mr Rutnam  
 Mr T Davies  
 Mr Cropper  
 Mr Tyrie  
 Mr Call

Ch: One further point (telephoned by Mr Monck). The total size of the BS workforce affected by the proposals is 6,500. More than this no. have become redundant from British Govt since Jan 84.

(E(A) 10 MAY 1988

Put things into perspective!

Mr Clarke's paper on British Shipbuilders (BS) for tomorrow's E(A) meeting seeks clearance for his proposal that Intervention Fund (IF) support to public sector yards in Great Britain should end and that there should be an early statement to that effect. He hopes it will be agreed that Mr King will make a similar statement at the same time about Northern Ireland. We have heard that Mr Clarke wishes to make a statement this Wednesday or Thursday.

### Line to Take

2. You are recommended to support Mr Clarke strongly on the general policy of an early end to IF support for public sector shipbuilders. If Mr King cannot agree to this because of the position at Harlands and Wolff, you are recommended to press for an early announcement on GB alone, ie you are recommended not to allow a statement on GB to have to wait for a decision on NI.

3. You are recommended to insist that Mr Clarke agrees to

the Chief Secretary's proposals on where expenditure provision associated remedial employment measures should be found. JW

### Background

see CST → Clarke letter of 4/5  
(behind first divider); + Clarke → CST 2  
Ripkeind → CST of 6/5.

4. Little has changed since the Prime Minister's meeting of 31 March. A copy of your minute for that meeting, circulated belatedly, is attached, together with your recent minute of 29 April. It remains our view that:

Notes  
in data }  
sequence,  
behind divider

(i) merchant shipbuilding in the UK is an uneconomic activity, and it is unlikely to become economic in the foreseeable future;

(ii) subsidies for merchant shipbuilding make sense only as an employment support measure, but as such they are indefensibly poor value for money;

(iii) therefore ideally we would end all support for merchant shipbuilding immediately; but

(iv) recognising the political difficulties of that, a coherent policy is

(a) termination of support to public sector shipbuilders;

(b) any privatisations of shipbuilding yards to be if possible on terms which do not entrench continued IF support to the private sector (ie the yards to be sold with dowries compensating for lack of future IF, rather than on an understanding that IF will continue to be available).

5. This is Mr Clarke's prescription, which you will wish to support strongly. This meeting will be in effect his third or fourth attempt this year to get a comprehensive policy on BS cleared. However you will need to be guarded on the following points.

## Terms of Privatisations

6. Amongst BS yards the strongest privatisation candidate is Govan, on the Clyde. Negotiations with Kvaerner are proceeding on the basis of a dowry rather than continuing IF. The 31 March meeting fixed the limit on a dowry at £75 million. But Kvaerner may still resort to demanding IF instead, and the EC may block a dowry on the basis that, by rolling forward future IF, it would breach limits on aid to shipbuilders. The 31 March meeting agreed that the priority was disposal, if necessary with IF. You should remind colleagues that a dowry in lieu of IF is much to be preferred, and that if continuing IF is conceded any dowry should be minimal. A coherent policy on closure/disposal of BS should help the EC Commission to be sympathetic to a large dowry.

7. There are also interests in acquiring the Appledore yard in Devon, the Ferguson yard on the Clyde, the Clark Kincaid engine works and the Marine Design Consultants. For the first two facilities, the aim should again be to avoid commitments to continuing IF. For all privatisation candidates, DTI will need to agree with the Treasury what the negotiating limits should be. The Annex to Mr Clarke's paper suggests that dowries are not necessarily cheaper than continuing IF. Indeed this follows automatically from calculating a dowry maximum as the sum of avoidable closure costs plus what <sup>can</sup> IF would <sup>otherwise</sup> be given. But dowries have the virtue of fixing what would otherwise be uncertain future support costs, and they limit those costs. DTI assume that the EC will abolish IF by the middle of the next decade but this cannot be guaranteed. Dowries are thus much to be preferred.

8. There do not seem to be any serious expressions of interest in NESL. But the door should be kept open, and this has implications for the terms of an announcement on remedial measures (below). The contractual problems at NESL have not been resolved.

The buyer has been given until 19 May by Lloyds Bank and ECGD to remedy a technical default under the loan agreement.

9. Mr Clarke's proposals assume that warship yards would continue to be excluded from IF for merchant order, and that private yards currently eligible for IF would continue to receive it as at present. It would be possible to end all IF in due course if the terms of disposal of BS yards did not entrench it.

### Northern Ireland

10.. Mr King will argue that he cannot make a statement on NI until he has been seen to do justice to the proposed order from Ravi Tikoo for Harlands. But a decision will not be possible before July. Mr Clarke is briefed to argue that Mr King could safely announce the end of IF to the public sector in NI, on the basis that he would wish to sell Harlands to Tikoo before allowing them to start work on his project (thereby avoiding potentially massive contract losses falling on the public sector).

11. A detailed brief on NI is at Annex A.

12. We recommend against allowing policy on BS to be held up whilst the Tikoo order is assessed. If necessary Mr Clarke should go ahead making clear that policy on NI is a separate issue. If Mr King can join him in an early statement, that is well and good provided Mr King does not imply that a privatised H&W would get IF for the Tikoo order. Our preference would be that any disposal of H&W would again avoid a commitment to continuing IF.

13. The meeting should agree precisely what Mr King would say on H&W if questioned after Mr Clarke's statement. If no firm policy on NI can be agreed, we suggest the fallback of Mr King saying that a statement on H & W will be made when the position on Mr Tikoo's order is clearer.



## Remedial Measures

14. Detail is at Annex B. There are two traps to guard against. First, Mr Clarke should not announce the measures in terms which commit expenditure which would be inappropriate if NESL were privatised so as to save many jobs there. Any announcement should therefore be contingent and should thus avoid specific numbers as far as possible.

15. Second, not all the remedial measures he is proposing have been agreed. If he (and Mr Rifkind)\* were prepared to accept that they should absorb the costs of these measures in existing provision (see below) we should be more relaxed, but until they do so they should not announce measures with implications for the Reserve.

## Financing

16. In his letter of 4 May the Chief Secretary offered Mr Clarke a deal in which agreed disposal/closure costs of BS, which could exceed £100 million this year, would be met from the Reserve, but remedial measures in 1988-89 (now estimated in Mr Clarke's paper at around £6-7 million) would have to be absorbed by existing provisions, with later years for discussion in the next Survey. Mr Clarke says he has reached 'broad agreement' on financing, but that is wrong. He wrote to the Chief Secretary on 6 May proposing that he should only absorb the cost in this year of advance factory building (now estimated at some £2 million) with other costs being met by the Reserve (some £3 million in England and £1 million in Scotland\*). You are recommended to reject this and to press for acceptance of the CST's proposal. If there is no agreement at the meeting, this issue should be resolved rapidly before any statement is made.

17. The mechanism of financing BS needs to be clarified. Mr Clarke proposes to continue to inject Public Dividend Capital (PDC) after telling Parliament that no dividends are expected. This course has been agreed with Treasury Solicitors and Treasury officials, but we need to clear the detailed wording of the statement on this point.

\* Mr. Rifkind's letter today bidding for remedial measures in Scotland to be met entirely from the Reserve. This should be resisted.

18. A summary of key points to make at the meeting is attached.

*Wing*

W GUY

SECRET

POINTS TO MAKE

(i) Support general policy of ending IF to public sector yards.

(ii) *Mr Clarke should come back to colleagues if any question of*  
 Any disposals of yards should preferably not be on terms making commitment to future IF.

(iii) Terms of disposals need to be cleared with Treasury.

(iv) Should be no commitment to precise remedial measures until scale of redundancies clear, eg note slim chance of buyer for NESL

(v) Need prompt agreement on expenditure provision for remedial measures

(vi) Early statement on BS necessary. Preferable to announce same policy in NI at some time. But accept Mr King not in position to end contract support for Harlands until he has considered details of the Tikoo order.

(vii) However if Harlands is treated separately Mr King must not prejudice position on Harlands and must avoid any commitment to ~~contact~~ *Contract* support. He should keep you informed of discussions on privatisation of the yard.

[Amendment telephoned by Mr Clarke]

## HARLAND &amp; WOLFF

Mr King argues that he cannot associate Harlands with Mr Clarke's proposed statement on British Shipbuilders and in particular with the withdrawal of Intervention Fund support for publicly owned yards. He claims that to do so would frustrate consideration of the possible cruise line order (P3000) for Mr Tikkoo. He seeks confirmation of his tactics of allowing Harlands to finalise the costings and contract support proposals for the P3000 and aims to reach a view on the project by July.

Comment

There has been extensive publicity about the P3000 in recent weeks following the announcement of the project by Mr Tikkoo and Harlands. Mr King and his Ministers have been at pains to put on record that proposals have not yet been submitted to them and that when they are, they will require careful consideration before a decision is reached on government support. (In fact NI Ministers have distanced themselves so assiduously from the project that they have been criticised for lacking enthusiasm for it.)

Provisional estimates of P3000 contract costs will not be available from Harlands until later this month. These will require very careful examination given the yard's past record of unrealistic pricing, cost overruns and delays. It is clear that Mr King will not be in a position to return to colleagues with his proposals much before mid-July.

In her summing up of the meeting on 31 March, the Prime Minister said that colleagues recognised the need to be seen to be considering all the possibilities for the future of the yard. You have also commented that the position on Harlands may need to be reserved until the costings for the cruise ship are available.

Mr King's position is therefore acceptable. But while it is reasonable for him to ask that Mr Clarke's statement should not prejudice the Government's position on Harlands, it is at the same

time essential to seek an assurance from him that anything he says does not prejudice that position also.

Line to Take

accept that Mr King is not in a position to announce ending of contract support for Harlands until he has considered detailed proposals on the P3000; but,

insist he does not prejudice the Government's position on Harlands and continues to avoid any commitment to contract support; and

ask him to keep you in touch with progress on his discussions concerning the privatisation of the yard.

## REMEDIAL MEASURES

A1. Mr Clarke proposes a range of remedial measures for closure areas. There would be an enterprise company for retraining, counselling and enterprise activities spending £13m in Scotland (£6m if Govan is sold to Kvaerner). In England the enterprise company would spend about £24m, including £7.5m on advance factories in Sunderland. There is also to be an enterprise zone at Sunderland. (See paragraph 9 and the Annex to E(A)(88)26.)

A2. While the remedial measures are not in themselves contentious, they do contain some objectionable features on which we recommend that you make the following points:

(i) Announcement of remedial measures should make clear they are contingent on need. Paragraph 8 of E(A)(88)26 shows Mr Clarke's wish to announce the remedial measures early. Any announcement should make it clear that the event, timing and scale of any remedial measures is contingent on the event timing and scale of closures, particularly given the possibility (although seemingly very remote) of there being a purchaser for NESL. This is especially important for the advance factory building and the enterprise zone.

(ii) Remedial Measures outside Sunderland have not been agreed. Sunderland measures have been agreed; measures elsewhere (ie Bideford and Scotland) not. You need not object to counselling, retraining and limited enterprise promotion elsewhere as envisaged in the paper, but only on the assumption that Mr Clarke and Mr Rifkind agree to absorb the 1988-89 costs - see (iii) below.

(iii) Costs of remedial measures should be borne by departments. Paragraph 9 of E(A)(88)26 is wrong; agreement on financing has not been reached. The Chief Secretary's letter of 4 May 1988 made clear that in both England and Scotland:

(a) costs of remedial measures in 1988-89 should be borne by departments; and

(b) costs of remedial measures in later years were a matter for the Survey.

SECRET

For England, Mr Clarke's reply of 6 May 1988 accepts the point for later years; he offers to fund 1988-89 factory building (£2-3m) from DTI resources. But he wants the Reserve to pick up the costs the enterprise company (ie some £3m in 1988-89), ie for DTI to pay no more than half of the total costs of the 1988-89 remedial measures. Given the need to avoid prejudicing the Survey, the pressure on the Reserve, the major concession made on costs of closure and the trivial sums involved on remedial costs we recommend that Treasury Ministers should stand firm.

For Scotland, Mr Clarke has disclaimed responsibility for funding any Scottish remedial measures and Mr Rifkind has not chosen, so far, to make any bid. Nor has he replied to the Chief Secretary's proposals; so they are the last word on Scotland and should remain so.

(iv) The Enterprise Zone must be appropriate in scale. It has been agreed that there is to be a new zone at Sunderland, but the details have not been settled. The current working assumption is that the size of the zone will be commensurate with the total closure of NESL. If there were to be some substantial continuing activity/employment at NESL then there would need to be a corresponding scaling down of the Enterprise Zone, both in order to ensure that the costs of the zone are reasonably commensurate with the problems of retrenchment and also to meet possible objections from the European Commission (who we understand are being increasingly difficult over enterprise zone proposals).

IAE2 Division  
MA Waller 270 4659  
M Romberg 270 4662

SECRET

SECRET



SCOTTISH OFFICE  
WHITEHALL, LONDON SW1A 2AU

The Rt Hon John Major MP  
Chief Secretary to the Treasury  
Treasury Chambers  
Parliament Street  
LONDON  
SW1P 3AG

CHIEF SECRETARY	
9 MAY 1988	
TO	Mr Guy
TO	CX FST Mr Anson
	Mr Monck Mr Burgess
	Mr Moore Mr Peiso
	Mr Turnbull Mr AM White

9 May 1988

*Dear John,*  
BRITISH SHIPBUILDERS

*Mr Waller Mrs Brown Mr Call.*

You sent me a copy of your letter of 4 May to Kenneth Clarke.

I have considered your proposal that I fund the costs this year of any remedial measures in Scotland arising from our decisions on British Shipbuilders. To the extent that additional demands will fall on the SDA and local bodies in receipt of funding through my programmes, there may be remedial costs falling on my programmes which I am prepared to bear without seeking additional provision. So far as Kenneth's proposal for an enterprise company is concerned, this is a body which I consider should be established, funded and operated on a Great Britain basis. When enterprise activities have been promoted through other nationalised industries - steel, coal, rail - the funding responsibility has always, I believe, fallen to the Department dealing with the respective industry.

I see no reason to take a different approach on this occasion. In my opinion, all the funds should be provided as a call on the Reserve, as part of the closure costs of the Corporation which will be the channel through which the funds are paid to the company. I do not dispute that the remedial costs are likely to be relatively modest, but this is an argument which cuts both ways. It does of course assume that the company is funded on an annual basis, rather than established with an adequate endowment. That is perhaps an assumption which bears further examination, and would of course change the level of costs which might fall on Kenneth or me under your proposals.

Copies of this letter go to the recipients of yours.

*Yours ever,  
Malcolm Rifkind*

MALCOLM RIFKIND





Inland Revenue

Policy Division  
Somerset House

FROM: P LEWIS  
EXT: 6371  
DATE: 10 MAY 1988

PS/FINANCIAL SECRETARY

## TAXATION OF SEAFARERS

1. The Chancellor raised a couple of points on my note of 6 May (Mr Taylor's note of 9 May).

Cost of relaxing the 100% foreign earnings deduction for everyone

2. We can do little more than guess at the broad order of magnitude of the cost of extending the 62 day rule to 90 days (and making a corresponding reduction in the fraction from 1/6th to 1/4) because we have no information about people who just fail to qualify at present (or what behavioural changes an easing of the rules might bring).

3. Nor is there much information available centrally about the number of claimants at present of the 100% foreign earnings deduction, but we tentatively estimate that the cost of this

cc Chancellor  
Chief Secretary  
Paymaster General  
Economic Secretary  
Sir P Middleton  
Mr Scholar  
Mrs Case  
Mr Revolta  
Ms Sinclair  
Mr A R Williams  
Mr Cropper  
Mr Tyrie  
Mr Call  
Mr C Jenkins (OPC)

Chairman  
Mr Isaac  
Mr Painter  
Mr Beighton  
Mr Lewis  
Mr McGivern  
Mr Cleave  
Miss Rhodes  
Mr Keith  
Mr R H Allen  
Mr O'Brien  
Mr Fraser  
Mr Alpe  
Mr I Stewart  
Mr K Allen  
Mrs C Williams  
PS/IR

relief is currently of the order of £50 million. Under the proposed relaxation the 365 day rule would still remain, so people would still need to spend a considerable period abroad to qualify, even though they would be allowed to spend somewhat longer in the UK. If the number of claimants increased by half, the cost would go up by something of the order of £25m.

Position of the shipping companies if a limited exemption for seafarers introduced

4. I am sorry if there has been any misunderstanding about the appropriate "baseline" for measuring the effect of these proposals on the shipping industry.

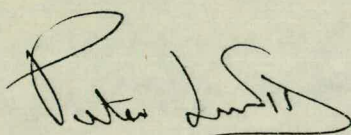
5. My comments were based on the present position, in the sense that seafarers in much of the deep-sea part of the shipping industry at present enjoy - through the absence of PAYE - an unintended tax relief which is both quite extensive and not subject to any rules about types of ship or voyage.

6. When I said that the shipping industry would, with the first proposal, regard themselves as worse off than at present, I had in mind that the reintroduction of PAYE, coupled with an announcement of a relief along these lines, would leave those companies not operating PAYE in a worse position than they are today, because the new relief would be more limited and tightly controlled than the de facto exemption they now enjoy.

7. I had regarded the present position as being the enjoyment of the de facto "PAYE exemption" since we have not yet told the shipping companies that we think they should be operating PAYE. But if you take the present position to include the decision to enforce PAYE from some future date, then, as the Chancellor has commented, it must be the case that a new relief, however limited, would improve rather than worsen their position as compared with what it would otherwise be.

8. Perhaps I might just add that this question of the "baseline" is crucial in evaluating the scale of assistance needed to meet the Government's shipping/defence objectives.

What Department of Transport seem to be arguing is that even with the benefit of the present "PAYE exemption" there are shortages of certain categories of ship required for defence purposes. If that is so, and if the Government wish to improve the availability of those ships after the "PAYE exemption" has been withdrawn, it seems necessary to give the shipping companies some new assistance which exceeds the value of the present "PAYE exemption", however they evaluate that. On the face of it, the new reliefs discussed in my note of 6 May may not even get you back to square one after PAYE has restarted (because they are more limited), let alone provide the additional assistance as of now which it is suggested the shipping companies need if they are to operate sufficient ships of the kind required for defence purposes.



P LEWIS

RESTRICTED

BF 13/5



FROM: MISS M P WALLACE

DATE: 10 May 1988

PS/FINANCIAL SECRETARY

cc PS/Chief Secretary  
Sir P Middleton  
Mr Anson  
Mr Monck  
Mr Phillips  
Miss Peirson  
Mr Burgner  
Mr A M White  
Mr Call

**JAMES MACKIE**

The Chancellor was grateful for your minute of 6 May, which he has noted.

A handwritten signature in cursive script, appearing to read 'M P Wallace'.

MOIRA WALLACE



FROM: J J HEYWOOD

DATE: 11 May 1988

PS/CHANCELLOR

cc PS/Chief Secretary  
PS/Paymaster General  
PS/Economic Secretary  
Sir P Middleton  
Mr Scholar  
Mr Culpin  
Mrs Case  
Mr McIntyre  
Mr Cropper  
Mr Tyrie  
Mr Isaac - IR  
Mr Lewis - IR  
PS/IR

**TAXATION OF SEAFARERS**

The Financial Secretary has discussed Mr Lewis' minute of 6 May with the Chancellor and had a further discussion with officials.

2. The Chancellor and the Financial Secretary agreed that option (a) in Mr Lewis' minute should be taken no further at this stage. The Financial Secretary has therefore concentrated on option (b) which would increase the number of days that can be spent in the UK without prejudicing a claim for the 100% foreign earnings deduction from 62 days to 90 days. (It would also be sensible to increase the "fraction" from 1/6 to 1/4).

3. This relaxation would not be operationally or legislatively difficult and at least would not involve the introduction of a new relief.

4. The Financial Secretary considers that aside from tax policy considerations and the possibility that it will lead to pressure from other groups, the main difficulty with option (b) is the fact that at present we have very little information on how effective it is likely to be.

CONFIDENTIAL

5. Compared with the present position, the only people who will benefit from option (b) are seamen who are currently paying tax. Those already covered by the 100% foreign earnings deduction and those not paying tax because PAYE is not being operated will enjoy no benefit at all. But once PAYE is re-introduced some of those who would otherwise have started paying tax would benefit from the extended relief.

6. Unfortunately we have no information on the numbers eligible for the relief as it now stands, nor of the number of UK seamen not paying tax because PAYE is not being operated. Ideally we would need not only this basic data, but also further information on the numbers who would benefit from the proposed relaxation, and the extent to which these seamen are working on deep-sea vessels which are on the UK/IOM registers (ie those most relevant to the defence issue).

7. The Financial Secretary has asked the Revenue to consult DTp on whether they have any better idea of the number of seamen who might be affected by the relief, and the categories into which they fall, to see if we can form any clearer picture of what the effect and the cost of this change would be. But if the Revenue are right in thinking that PAYE is not being operated for a substantial part of the deep sea trades it seems likely that extending the relief will do little more than reduce the adverse effects on the shipping companies of re-introducing PAYE. Given the likely limited impact, the proposal would be unlikely to head off the pressure for subsidies to meet the wider shipping objectives.

8. The Financial Secretary will minute the Chancellor again when he has received a further report from the Revenue on the implications of any information DTp manage to turn up.

9. The Financial Secretary has not considered any possible public spending measures.

*J.H.*

JEREMY HEYWOOD  
Private Secretary

SECRET

Copy No 3 of 17

1. Mr Waller 13/5  
2. Chief Secretary

From: Michael Romberg

13 May 1988

File: IRARD G/23

cc PS/Chancellor  
Mr Monck  
Mr Burgner  
Mr Moore  
Miss Peirson  
Mr Tunbull  
Mr AM White  
Ms Mary Brown  
Mr Guy  
Mr MG Richardson  
Mr BH Potter  
Mr Wood (LG2)  
Mr Call

**BRITISH SHIPBUILDERS: FINANCING REMEDIAL MEASURES**

**Summary**

1. The E(A) meeting on 10 May 1988 did not discuss the financing of remedial measures. Mr Ridley has accepted the DoE costs of the Sunderland Enterprise Zone. But otherwise Ministers are disagreed. You had written to say that departments should meet the costs in 1988-89; later years were for the Survey. Mr Clarke and Mr Rifkind have written seeking some finance from the Reserve for this year also. Accepting this proposal would prejudice your position in the Survey. You are advised to write to Mr Clarke and Mr Rifkind reiterating your views. A draft letter is attached.

**Background**

2. Your letter of 4 May 1988 made clear that in both England and Scotland:

(i) costs of remedial measures in 1988-89 should be borne by departments; and

(ii) costs of remedial measures in later years were a matter for the Survey.

SECRET

SECRET

3. For DTI in England, Mr Clarke's reply of 6 May 1988 accepts the point for later years; he offers to fund 1988-89 factory building (£2-3m) from DTI resources. But he wants the Reserve to pick up the costs of the enterprise company (£2.65m in England in 1988-89), ie for DTI to pay no more than half of the total costs of the 1988-89 remedial measures.

4. For Scotland: Mr Clarke has disclaimed responsibility for funding any Scottish remedial measures. Mr Rifkind's letter of 9 May 1988:

(i) undertakes not to seek additional provision for the Scottish Development Agency &c;

(ii) argues that the enterprise company should be set up and financed on a Great Britain basis; and

(iii) calls for the full costs of the enterprise company to be met from the Reserve.

5. For DoE in England: Mr Ridley's letter of 20 April 1988 on the Sunderland Enterprise Zone accepts that the costs of the Urban Development Corporation (UDC) as Zone authority should come from his existing provision but does not commit himself to not seeking extra funds for UDCs generally.

Comment

6. The E(A) meeting on 10 May 1988 did not cover the financing of remedial measures. The position rests on the correspondence. You have gained agreement that later years are a matter for the Survey. We do not think you should concede anything on the issue:

(i) the remedial measures for Scotland and Bideford (cost £1.6m in 1988-89, £9.3m in total) have not yet been agreed by Ministers. There is no reason to object to them provided the 1988-89 costs are met by DTI and the Scottish Office (who meets them is a matter to be sorted out between Mr Clarke and Mr Rifkind); and

(ii) you already face substantial pressure on the Reserve and have made a major concession on costs of closure.

Against this background, and given the trivial sums involved (£3.75m in Great Britain for the enterprise company in 1988-89) we recommend that you should stand firm. A draft letter is attached.

MR

Michael Romberg  
IAE2; 270 4662; Rm 114/G

SECRET



**SECRET**

DRAFT LETTER FROM THE CHIEF SECRETARY  
(draft of 13 May 1988)

The Right Honourable  
Kenneth Clarke QC MP  
Chancellor of the Duchy of Lancaster  
Department of Trade and Industry  
1 - 19 Victoria Street  
London  
SW1H 0ET

**BRITISH SHIPBUILDERS: FINANCING REMEDIAL MEASURES**

1. Thank you for your letter of 6 May 1988. I am also replying to Malcolm Rifkind's letter of 9 May 1988 and to Nicholas Ridley's of 20 April 1988.
2. I am pleased that you have felt able to accept my suggestion that the costs of remedial measures in future years should be decided in the Survey. That should enable us to take a well informed view of priorities.
3. Nicholas Ridley has helpfully agreed that the costs of the Enterprise Zone which is to be established at Sunderland if there is a complete or substantial closure of NESL are to be met from his existing provision. Since the scale of the Zone would need to be proportionate to the scale of redundancies, any substantial continuing activity at NESL should lead to a lower call on his programmes.
4. And I am grateful to you for agreeing to finance the 1988-89 costs of advance factory building from your own provision in the event that a complete or near-complete closure of NESL makes it necessary. Similarly I am pleased that Malcolm has agreed to meet any extra costs falling to the Scottish Development Agency and other organisations from within his existing provision.

**SECRET**

**SECRET**

5. That leaves the costs of the enterprise company in 1988-89, only some £3.75m if Govan is sold to Kvaerner, of which £1.1m would be spent in Scotland and £2.65m in England. We have not discussed or formally agreed the need for the remedial measures for Scotland or Bideford which total some £1.6 million in 1988-89 and £9.3 million in total. I am prepared to accept that there is a case for the expenditure on the basis that the first year costs of the enterprise company's activities do not constitute a claim on the Reserve. I am sorry to appear difficult but I have already agreed to meet the very substantial costs of the British Shipbuilders closure from the Reserve. As you know, the Reserve for this year is already under considerable pressure. Given what has already been agreed, and the modest sums involved for the enterprise company in the year, I therefore must look to you and to Malcolm Rifkind to finance these costs in 1988-89.

6. I am copying this letter to the Prime Minister, David Young, Malcolm Rifkind, Tom King and Nicholas Ridley and to Sir Robin Butler.

**JOHN MAJOR**

**SECRET**

SECRET



Chancellor  
FST  
Sir Peter Middleto  
Mr Anson  
Mr Monck  
Mr Burgner  
Mr Moore  
Miss Peirson  
Mr Turnbull  
Mr Waller  
Mr A M White  
Mrs Brown  
Mr W Guy  
Dr Baker  
Mr A Hurst  
Mr Sharrat  
Mr N Williams  
Mr Rutnam  
Mr Cropper  
Mr Tyrie  
Mr Call

Treasury Chambers, Parliament Street, SW1P 3A

The Rt Hon Kenneth Clarke QC MP  
Chancellor of the Duchy of Lancaster  
Department of Trade and Industry  
1 - 19 Victoria Street  
London  
SW1H 0ET

4<sup>th</sup> May 1988

*Dear Ken,*

#### BRITISH SHIPBUILDERS

We spoke last night about your letter to Nigel Lawson of 18 April and I promised to consider afresh the extent to which I could entertain a claim on the Reserve for the various costs arising on British Shipbuilders and the extent to which a contribution should be found from the DTI budget.

I am aware that the settlement on the BS EFL which we reached in the last IFR was provisional, and of course I recognise that the costs of implementing your proposals for BS, which I fully support, will be substantial. I accept that you will need extra provision. But the fact is that you have not previously made a bid for any extra provision and I have not agreed to one.

Whilst I am quite prepared to accept the bulk of the costs of rationalising your policies as a charge to the Reserve, I cannot accept your proposition that all closure and disposal costs, as well as the remedial measures, should automatically be met in full from the Reserve.

You did not attempt to quantify the 1988-89 costs in your letter. But we know that they could easily be well in excess of £100 million if Govan were sold with a dowry of £75 million and all other BS facilities were closed or sold this year with dowries equal to the restimated closure costs.

This comes at a time when the Reserve for this year is already under pressure. Before April was out, claims on the Reserve of over £2½ billion had been made public. Severe restraint will be necessary for the remainder of the year if we are to convince our supporters and critics of our determination to maintain control over public spending.

SECRET

It was against this background that I asked my officials to explore with yours the scope for offsetting savings to meet in part the increased provision for the BS EFL which will be necessary. I had in mind a package involving equal contributions from DTI, Scottish Office and the Reserve to the agreed costs of disposal of Govan, and equal contributions from DTI and the Reserve to the agreed £7.6 million figure for advance factory building in Sunderland and the previously tabled costs of counselling, retraining and enterprise promotion in England. I am sorry that you were surprised to hear this. It seems to me that such an examination is always necessary, and that it is right similarly to look to Malcolm Rifkind for a contribution.

I am, however, mindful of the urgent need to reach agreement on the distribution of these costs and the problems which the need to reorder priorities to the extent necessary to find a significant contribution might cause you and Malcolm. I have therefore looked hard to see what might be the minimum I could accept. On this basis I would be prepared to accept all the agreed costs of disposal of Govan as a claim on the Reserve, together with costs of disposal or closure of other facilities which may be agreed between us, if you were willing to absorb the relatively modest costs in 1988-89 of remedial measures in England. I would need to look to Malcolm Rifkind similarly to fund the costs this year of any remedial measures in Scotland. The cost of any remedial measures in later years would be for discussion in the forthcoming Survey.

I hope that you will agree that this is a helpful basis for a quick agreement.

I am copying this letter to the Prime Minister, David Young, Malcolm Rifkind, Tom King and Nicholas Ridley, and to Sir Robin Butler.

Yours Ever,  
John

JOHN MAJOR

Rt. Hon. Kenneth Clarke QC MP  
Chancellor of the Duchy of Lancaster and  
Minister of Trade and Industry

Rt Hon John Major MP  
Chief Secretary  
HM Treasury  
Parliament Street  
LONDON  
SW1P 3AG

Department of  
Trade and Industry

1-19 Victoria Street  
London SW1H 0ET

Switchboard  
01-215 7877

Telex 8811074/5 DTHQ G  
Fax 01-222 2629

Direct line 215 5147  
Our ref  
Your ref  
Date 6 May 1988

CHIEF SECRETARY	
REC	- 9 MAY 1988
ACTION	
TO	
FROM	
DATE	
BY	
REMARKS	

*Dear Chief Secretary*

## BRITISH SHIPBUILDERS

Thank you for your letter of 4 May.

I welcome your acceptance that the costs of closure of British Shipbuilders, including the costs of disposal of Govan and other disposal and closure costs, should be met by the Reserve.

As I said when we met, in view of pressures on the Reserve this year, I am prepared to take on the costs in 1988-89 of advance factory provision in the context of decisions on closure. Given the reduced scale of advance factory building agreed by colleagues, and the time it will take to get a £7½ million programme under way, I would not expect to be able to spend more than £2-3 million in 1988-89. On the understanding that these costs will be carried through the proposed BS Enterprise Company, the later years' costs will need to be considered as part of BS's overall finances in the Investment and Financing Review. *lb.*

MY1ACM

Your letter however proposes that I should also pick up the current year costs of the enterprise package in England. This was not part of my proposal. These costs are intimately associated with the closure decision itself, and bear little relation to my Department's main programmes. I should therefore like to go back to the position I thought we had agreed, that the Exchequer and my Department should share the indirect costs in England in 1988-89, with DTI accepting the factory costs and the Reserve the rest.

I am not of course able to speak for Malcolm Rifkind in respect of Scottish closure costs.

I am sending copies of this letter to the Prime Minister, David Young, Malcolm Rifkind, Tom King and Nicholas Ridley, and to Sir Robin Butler.

Your sincerely,

*Peter Smith*

*- [unclear] [unclear]*  
*- [unclear] [unclear]*

??

KENNETH CLARKE

*(Approved by the Chancellor and signed in his absence)*

SECRET



SCOTTISH OFFICE  
WHITEHALL, LONDON SW1A 2AU

The Rt Hon John Major MP  
Chief Secretary to the Treasury  
Treasury Chambers  
Parliament Street  
LONDON  
SW1P 3AG

CHIEF SECRETARY
9 MAY 1988
Mr Guy
CX FST Mr Anson
Mr Monck Mr Burgess
Mr Moore Mr Peison
Mr Turnbull Mr Amis etc

9 May 1988

*Dear John*  
BRITISH SHIPBUILDERS

*Mr Wallis Mrs Brown Mr Cull*

You sent me a copy of your letter of 4 May to Kenneth Clarke.

I have considered your proposal that I fund the costs this year of any remedial measures in Scotland arising from our decisions on British Shipbuilders. To the extent that additional demands will fall on the SDA and local bodies in receipt of funding through my programmes, there may be remedial costs falling on my programmes which I am prepared to bear without seeking additional provision. So far as Kenneth's proposal for an enterprise company is concerned, this is a body which I consider should be established, funded and operated on a Great Britain basis. When enterprise activities have been promoted through other nationalised industries - steel, coal, rail - the funding responsibility has always, I believe, fallen to the Department dealing with the respective industry.

I see no reason to take a different approach on this occasion. In my opinion, all the funds should be provided as a call on the Reserve, as part of the closure costs of the Corporation which will be the channel through which the funds are paid to the company. I do not dispute that the remedial costs are likely to be relatively modest, but this is an argument which cuts both ways. It does of course assume that the company is funded on an annual basis, rather than established with an adequate endowment. That is perhaps an assumption which bears further examination, and would of course change the level of costs which might fall on Kenneth or me under your proposals.

Copies of this letter go to the recipients of yours.

MALCOLM RIFKIND



154c

3 MARSHAM STREET  
LONDON SW1P 3EB  
01-212 3434

*M. N. Williams*

What does X mean exactly?

My ref:

Your ref:

The Rt Hon Nigel Lawson MP  
HM Treasury  
Parliament Street  
LONDON  
SW1 3AG

THE  
20 APR 1988  
MRS BROWN  
CST, FST, SRP, M. DOOLEY  
MR ANSON, MR MONCK,  
MR O MOORE, MR BURGOER  
MS SEAMEN, MR WALLER  
MR A. M. WHITE, MR R. EVANS  
MR GUY, MR SHARRATT  
MR RUTLAND, MR N. WILLIAMS  
MR CALL

MB  
21/4

20 April 1988

Dear Chancellor,

SHIPBUILDING

You copied to me your comments of 30 March on the paper by the Chancellor of the Duchy of Lancaster of 28 March, of which I have also now seen a copy. I understand that at the Ministerial meeting on 31 March my proposal to include an EZ in the package of remedial measures for Sunderland in response to shipbuilding redundancies was given approval. Our officials are working on the detailed case.

I agree with your argument that our responses to such redundancies should be even-handed between the territories. For that reason I felt that there was a strong political argument to supplement the good technical case for a Sunderland EZ. I note your request that we should look to fund the remedial measures from within existing provision. I fully accept this in relation to the foreseen UDC expenditure within the proposed zone, where the costs of my proposal would be drawn from the UDC's provision (however, you would not expect me at this stage of the PESC cycle to commit myself for future years on the overall UDC programme.) The RSA costs will fall to DTI and Kenneth Clarke covered this in his original minute. The main zone benefits of rates and tax relief are not, of course, public expenditure costs.

X

I am copying this to the Prime Minister, David Young, Malcolm Rifkind, Tom King, Kenneth Clarke and Sir Robin Butler.

*Mr. Bugner*  
Obvious, but I take it to be a reference to X attached  
with MB  
21/4

Yours sincerely

*M. Williams*

*A D L*

PP. NICHOLAS RIDLEY

Perhaps, in the case of RSA, (X) is the sentence which is relevant.

(Approved by the Secretary of State and signed in his absence)

42/88 MB  
21/4







*[Handwritten signature]*

FROM: J M G TAYLOR

DATE: 13 May 1988

PS/FINANCIAL SECRETARY

cc PS/Chief Secretary  
PS/Paymaster General  
PS/Economic Secretary  
Sir P Middleton  
Mr Scholar  
Mr Culpin  
Mrs Case  
Mr McIntyre  
Mr Cropper  
Mr Tyrie  
Mr Isaac - IR  
Mr Lewis - IR  
PS/IR

**TAXATION OF SEAFARERS**

The Chancellor was grateful for your minute of 11 May.

*[Handwritten initials]*

J M G TAYLOR

may21

CONFIDENTIAL

PPSP

FROM: A M WHITE  
DATE: 13 MAY 1988

FINANCIAL SECRETARY

cc **Chancellor**  
 Chief Secretary  
 Paymaster General  
 Economic Secretary  
 Sir P Middleton  
 Mr Anson  
 Mr Phillips  
 Mr Monck  
 Miss Peirson  
 Mr Burgner  
 Mr Bradley  
 Mr Waller  
 Mr Sharratt  
 Miss Huleatt-James  
 Mr Call  
 My Hyett T.Sol.

JAMES MACKIE

Following your telephone conversation with Mr Viggers last Friday, I have had a series of discussions with Northern Ireland officials.

2. In the light of those discussions they have produced the attached revised draft letter setting out Mr King's proposals for the company and inviting colleagues to endorse them.

3. You will see that, consistent with Mr Viggers' request to you that, if at all possible, you should endorse the proposal as the best way forward, the draft leaves room for a paragraph giving Treasury Ministers views. I do not recommend that you should offer support to the proposal in this way.

4. As previously discussed, there is no economic justification for Government intervention to support this company, nor has Mr King sought to justify his proposals on these grounds.

5. If Mackies is to be supported then it will represent a sharp departure from the normal thrust of Government policy, a departure that, as recognised by colleagues in E(A), would be made on the basis of a judgement that the social and political consequences of closure were unacceptable. That judgement is clearly one for Ministers.

*Handwritten notes in red ink:*  
 Mr X, Central  
 We must say that, ~~the proposal~~  
~~is not~~ despite the mirror  
 important (with) in this  
 package, we are unequivocally  
 in favour of Mackie  
 & Mr. ~~the~~ ~~resum~~  
 Mr. Mackie  
 to be supported

CONFIDENTIAL

6. If Ministers wish to support Mackies, then the form of assistance proposed by Mr King is probably the least unacceptable in that it avoids State control and the equity investment that E(A) was clearly unwilling to contemplate.

7. The proposal still has profoundly unsatisfactory fixtures. While steps are proposed to strengthen the management of the company, ultimate control will continue to be in the hands of Mackies Trustees and the best that can be expected there is that Mr King will be able to persuade one of the present worthy but non enterpreneurial trustees to resign in favour of successor who can contribute business acumen.

8. There is also the unavoidable risk that by supporting Mackies in this (or indeed any other) way the Government would in all probability become liable to Mackies creditors if, despite this assistance, the company were to collapse.

9. However, we have been able to substantially reduce exposure on that front by getting the Northern Irish to seek assurances that the Northern Bank would not seek recourse against the Government in the event of a collapse, relying in those circumstances solely on its fixed and floating charge on Mackies assets to recover its £7½m overdraft exposure.

10. The proposal to finance the paying off as part of the assistance package proposed the £2m additional overdraft facility presently covered by a guarantee from Mr King is intended to further secure that position as well as reducing Mackies interest charges. (I shall be asking Mr King's officials to make this aspect of the assistance package clearer - the present wording is to say the least coy (paragraph 6, fifth to seventh sentences)). (I shall also suggest that they include a table setting out the proposed timing and composition of the three tranches of assistance envisaged.)

11. As Mr King has recognised throughout, the proposal is also at variance with the assurances on industrial assistance given to the PAC in the wake of De Lorean, which makes the need for a

statement, which Mr King proposes should be by way of Written Answer, unavoidable.

12. There is one point that still remains to be resolved - the question raised by the Foreign Secretary as to whether the proposals were notifiable to the European Commission, and if so whether there should be prior consultation with Brussels. That issue is being discussed with DTI and FCO officials and I have made it clear that final clearance cannot be given to Mr King writing until it has been resolved.

13. However, as it is not central to your consideration of the proposed package of assistance, I judged it better to submit now rather than waiting for resolution on this point.

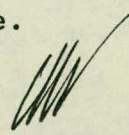
#### Conclusion and Recommendation

14. In my view, if James Mackie is to be assisted, the package now proposed, with the reduced exposure achieved by the assurances from the Northern Bank on non recourse to Government on its overdraft exposure, is probably the least unacceptable way of proceeding.

15. There remain weaknesses and disadvantages in what is proposed but the attached draft now adequately exposes them for colleagues.

16. If you agree, I recommend that you should authorise me to tell Mr Kings officials that, subject to the amendments needed to further clarify paragraph 6; the addition of a table showing the pattern of assistance proposed; and clarification of the point as to whether the assistance proposed falls within EC guidelines or is notifiable, the letter may be circulated to seek colleagues endorsement of Mr King's proposals.

X | 17. I do not recommend that you contribute a paragraph indicating support for the proposed package. If you agree I will tell Mr Kings officials that, while you do not support the proposal, you will not oppose it if colleagues are content to see it implemented to avoid the social and political consequences of withholding assistance and letting the company collapse.

  
A M WHITE

**CONFIDENTIAL****THIRD DRAFT OF LETTER FROM SECRETARY OF STATE TO THE PRIME MINISTER****JAMES MACKIE & SONS LIMITED**

1. During the discussion at the E(A) meeting of 25 April about the problems of this company in West Belfast, colleagues recognised the case for preventing closure of the company and indicated a wish to find a solution for Mackies within clear constraints. Colleagues were strongly opposed to Government assistance being made available in the form of equity finance.
2. This point was however made that avoiding an equity involvement could create difficulties over assurances previously given to PAC and that a sufficient degree of influence would be necessary to ensure that much needed management changes were put in place. Colleagues also suggested that we should not allow the existing owners to reap the potential rewards of a rescue made possible wholly by Government support. I was asked to consider the prospect of a £20m secured loan for the company and to consult with the Chancellor on this possibility.
3. Firstly I have considered fully the preferred option of putting in a £20m secured loan. I have sought advice on this point from Lazards who have been advising IDB. Their view is that there will be inadequate security within the company to support such a loan. The Northern Bank already has a fixed and floating charge over all the assets of the company as security for its £7.5m overdraft. The Bank considers that on break up, the assets would only just cover its exposure; this was the reason why the bank sought and obtained Government guarantee for a further £2m overdraft facility made available to the company in 1987. Since EA last discussed Mackies, a specific request by IDB has been made to the bank asking if it would be prepared to release ~~any part of the~~ <sup>security on the existing overdraft</sup> ~~to the Northern Bank~~. The Northern Bank has refused to make any concession on this point and in support of its attitude has cited Bank of England guidance on exposure to loans which are large in relation to a bank's capital base. I have therefore reluctantly concluded that the residual value of the company after meeting the overdraft liability to the Bank and even when augmented by additional assets in the form of new plant and machinery, could not provide sufficient collateral to secure adequately the Government investment. Furthermore we are advised that we could risk an embarrassing action for fraudulent preference by unsecured creditors if they were to lose money on a possible failure of the

## CONFIDENTIAL

company although this might not impose any additional financial penalty on Government.

4. Within the constraints outlined in E(A) we have been looking for a solution which might offer a practical way forward. I have to say that it has been difficult to come up with a solution which meets the clearly expressed wishes of colleagues without at the same time proposing an investment of public funds in a manner which could be difficult to defend as a proper and sensible use of public money. We have, however, produced an outline proposal which I am willing to support. Much work of a detailed nature would remain to be done but I am anxious to move forward as quickly as possible since the company's situation continues to be precarious. I have taken steps in the short term to extend the full £2m guarantee to ensure that the company does not collapse whilst we are resolving the matter.
5. The proposal is that I would authorise IDB to make available to the company assistance in the form of grant and loan. The grant would amount to £7.5m. This would be paid at normal IDB rates of selective assistance, mainly in the form of capital grants on expenditure in respect of buildings, plant and machinery. The balance of £12.5m would be made available in convertible loan stock. Our original intention to phase the assistance with stringent performance targets set at each stage would stand. Government would not take any direct shareholding in the company. The convertible loan stock would, however, carry rights to convert into shares in order to ensure that any potential capital gain which accrued on a future sale of the company would accrue largely to Government rather than merely to the existing owners. We would impose conditions on the package which would enable us to ensure that the necessary and quite essential changes to strengthen top management were made. In particular the conditions would permit appointment of a new Chief Executive together with a strengthening of the financial function. Coopers and Lybrand have advised that this degree of strengthening of management combined with essential new capital investment should allow the company to return to profitability. Other appropriate conditions would also be imposed on the basis of detailed professional advice.
6. This proposal is in line with the views of colleagues in that it avoids any Government shareholding in the company. However, the company's ability to continue to trade and to return to profit after re-equipping is wholly dependent on the injection of public money. In these circumstances I am advised that it would be difficult, if not impossible, for Government to avoid responsibility for those liabilities of the company which will be incurred in the normal course of trade with unsecured

CONFIDENTIAL

## CONFIDENTIAL

creditors (including redundancy payments), if the company should fail during the period of the rescue attempt. Although this responsibility must be assumed there are three important mitigating factors. First, Government has an existing guarantee commitment to the company's bankers of £2m. This guarantee would be withdrawn immediately thus releasing the existing IDB obligation to the Northern Bank. The need to reduce Mackies overdraft has been taken into account in the calculation of the first tranche financial requirements. Our firm expectation is that any possible obligation to creditors in the rescue period other than redundancy payments would be less than that existing guarantee commitment. Secondly, steps will be taken to ensure that no historic undisclosed liabilities are inadvertently inherited by Government. IDB has not come across any such 'skeletons in the cupboard' but would employ professional accountancy and legal advice to subject the company to a rigorous investigation. In the unlikely event that any major difficulty arises I would return to colleagues, before any commitment was entered into by IDB. Thirdly, it will be made clear to the bank that any possible future acceptance of liabilities by Government to unsecured creditors will not extend to any of the bank's lending to the company. clarify

7. This solution leaves the present ownership of the company with the Trust since Northern Bank has now made it clear that it will not take an equity investment in the company unless it has a matching investment from Government in like form. This was the proposition considered but rejected by E(A) on 25 April. I would propose however to explore ways of strengthening the Trust, with a view to the appointment of a new Trustee or Trustees with relevant business experience.
8. Apart from the possibility of IDB having to assume responsibility for the company's liabilities which is discussed above, there is a further difficulty. PAC was assured after the DeLorean case that in future industrial support would only be given to projects in which a substantial part of the financial resources is provided by the private sector. Despite vigorous efforts to find fresh private sector funding for Mackies, it has been clear for some time that its rescue depends almost wholly on Government support. Whilst this runs counter to the assurance to PAC, the fact is that the decision to support Mackies has been made by Ministers on social and political grounds in the context of the particular difficulties of West Belfast. It is a unique set of circumstances and not a straightforward case of industrial development assistance to a normal commercial project. I would propose to arrange to make clear to the House the exceptional nature of this support by way of a Written Answer, and would agree the text with the Chief Secretary.

## CONFIDENTIAL

9. In recognition of Government's dominant position in the arrangements for financing the company, I originally put to E(A) proposals which involved a significant degree of Government shareholding and control. The changes which have been made in these aspects of the proposal meet the wishes of colleagues but have inevitably brought with them a dilution in the degree of accountability; it also does not accord with the clear recommendation of our professional advisers, Lazards, who recommended a significant ownership and control position to facilitate the rescue of the company and its successful return to the private sector. The proposed arrangements are weaker in this regard but I fully understand and appreciate the concerns which colleagues expressed at E(A).
  
10. [I am satisfied that the package falls within the established EC guidelines for the provision of financial assistance to projects within Northern Ireland. [Recent discussions involving officials in HM Treasury, FCO and DTI have confirmed this. The Foreign Secretary had earlier suggested that it might be worthwhile sounding out the EC Commission about whether the proposals would be notifiable under Articles 92 and 93 of the Treaty since early warning and the political background might minimise any difficulties. The EC ceilings were set for all Member States in a 1979 Communication of the Commission on Regional Aid Systems; as the proposed funding for Mackies is not within an industry with special EC restrictions and as it falls within the EC limits for Northern Ireland there is no requirement to seek approval from Brussels. In the light of this I am sure colleagues will agree that any informal consultation with Brussels would not be desirable. It would introduce further delay and frustration in circumstances where we are acting within well established delegated limits. It would also risk French intervention given that Mackies' main competitor is French.]
  
11. [Treasury Ministers views .....
  
12. I believe, however, that this proposal does offer a workable way forward and I believe it fits well with the very clearly expressed views of colleagues at two recent Committee meetings. I would be grateful for the endorsement of colleagues to this outline proposal following which I will set in train the necessary detailed consultations and negotiations to implement the proposals.

TOM KING



FROM: M SHARRATT  
DATE: 16 MAY 1988

1. MR WHITE *WWS 16/5*
2. CHIEF SECRETARY

cc Chancellor  
Paymaster General  
Financial Secretary  
Economic Secretary  
Sir Peter Middleton  
Mr Anson  
Mr Phillips  
Mr Monck  
Miss Peirson  
Mrs Brown  
Mr Bradley  
Mr Inglis  
Mr Call

#### SHORT BROTHERS

Mr King has already warned colleagues of a serious problem in Shorts. That had come to light when the company's year-end figures revealed a sudden and massive increase in the reported cash requirements of about £35-40m (over 40 per cent). We understand that he will be writing shortly to explain more fully the position of the company and to seek agreement to his proposals for dealing with Shorts over the next few months.

2. Deloitte Haskins (Shorts' auditors) and Touche Ross, who monitor the company on behalf of the Department of Economic Development in Northern Ireland, were both commissioned to carry out urgent investigations into what had happened. Both have now reported and have uncovered very serious basic financial management deficiencies in the company. The Head of Finance and the Treasurer have both been dismissed and steps are being taken to establish proper monitoring, reporting and control systems. In the meantime the company has to inform DED of all payments in excess of £50,000 scheduled for the week ahead.

3. The irregularities were so serious that the final year-end position will not be known until the completion of a major accounting reconstruction exercise. Even the cash position will remain provisional until a full set of bank reconciliations is available and the books of account have been properly brought up to date. Deloitte's have diagnosed the problem as a failure to keep proper cash records with mis-posting a common occurrence, failure to capture transactions by the cash book system, excessive use of suspense accounts, and failure to check actual and reported cash balances.

4. It is still far from clear why these management shortcomings did not come to light sooner. Touche Ross have defended their role on the basis that they were reliant on reports from Shorts' officials and did not have access to the company's books. One of their main functions is to monitor current performance against plan. While they had signalled that they regarded the company's sales forecasts as optimistic, with the consequence that the EFL was at some risk, there was never any suggestion that the basic financial information was suspect.

5. Deloitte's and TR's investigations to date have not raised any question of fraud - simply gross mismanagement (Deloitte are carrying out a separate investigation on the possibility of fraud and we expect to see that report when it is available). We had asked for and obtained a note from NI officials on the background to the resignation of Price Waterhouse as auditors earlier this year. This followed difficulties between PW and Shorts - and in particular with Sir Philip Foreman, the recently retired Chairman and Managing Director - over the delayed 1986-87 Accounts. Those were eventually qualified by PW in respect of Shorts' valuation of stocks and work in progress. The NI note reported that the detailed reasons for the qualification of last year's accounts were being considered by DED with a view to further action being taken if necessary. The breakdown in the company's accounting arrangements came to light before we were able to take this further.

6. We had asked early last year to be more closely involved in regular monitoring meetings between Shorts and NI officials. But this was resisted by NI officials on the grounds that existing arrangements involving Touche Ross as an intermediary were satisfactory. In the light of these serious failings in the company's management, which clearly reflect also on the monitoring arrangements, we have warned NI officials that we will now insist on direct access to company officials.

7. Mr Lund, who succeeded Sir Philip Foreman as Chairman on 1 April, clearly cannot be held responsible for what has happened (although there must be a question mark over the role of Mr McNulty, the former Finance Director who has now become Managing Director). The new Chairman had already commenced a full review of the company's corporate strategy at the request of Mr King. This followed Northern Ireland and Treasury officials dissatisfaction with the corporate plan prepared under the previous chairman's stewardship. The review is due to be completed by the end of June and on the basis of that, Mr King's aim is to bring proposals to colleagues on the company's future structure before the summer recess. Our view is that it is imperative that this work be completed urgently. Nearly two years have been lost by the refusal of the previous board to face realistically the options open to the company and critical decisions cannot be much longer delayed. For this reason we support NI officials view that collective discussion of Shorts should be postponed until the summer. But in the meantime we will ensure that all necessary steps are taken to bring the company's accounting arrangements up to scratch and that the company is kept on a strict financial "drip feed" until strategic decisions can be taken.

8. We will provide further briefing when Mr King writes.

*M Sharratt*

M SHARRATT



FROM: MISS M P WALLACE

DATE: 16 May 1988

PS/FINANCIAL SECRETARY

cc PS/Chief Secretary  
PS/Paymaster General  
PS/Economic Secretary  
Sir P Middleton  
Mr Anson  
Mr Phillips  
Mr Monck  
Miss Peirson  
Mr Burgner  
Mr Bradley  
Mr Waller  
Mr A M White  
Mr Sharratt  
Miss Huleatt-James  
Mr Call  
Mr Hyett - T.Sol.

**JAMES MACKIE**

The Chancellor has seen Mr White's minute of 13 May.

2. He has commented that in his view there is no question of contributing a paragraph to Mr King's paper indicating support. We must say that, despite the minor improvement contained in this package, we are unequivocally of the view that there should be no Government rescue, and that Mackie's should go into receivership.

A handwritten signature in dark ink, appearing to read 'M.P. Wallace'.

MOIRA WALLACE



MP

FROM: J J HEYWOOD  
DATE: 16 May 1988

MR A WHITE

cc PS/Chancellor  
PS/Chief Secretary  
PS/Paymaster General  
PS/Economic Secretary  
Sir P Middleton  
Mr Anson  
Mr Monck  
Miss Peirson  
Mr Burgner  
Mr Bradley  
Mr Waller  
Mr Sharratt  
Miss Huleatt-James  
Mr Call  
Mr Hyett T.Sol

JAMES MACKIE

The Financial Secretary has seen your minute of 13 May. He agrees that he should not contribute a supportive paragraph. But he does not agree that he should not oppose the proposal - he would prefer to write-in opposing the proposal and arguing that Mackies should go into receivership.

92

JEREMY HEYWOOD  
Private Secretary

SECRET

£100 million, to which I agreed in my letter of 4 May, associated with the disposal of Govan and closure or disposal of other BS facilities. I would not necessarily wish to challenge the need for additional enterprise measures covering not only Sunderland but also Scotland and Bideford. But given the major claim on the Reserve I have already conceded and the modest overall size of the spend on remedial measures this year, I consider it entirely reasonable that these costs should be found from within existing programmes. I must therefore continue to look to you and to Malcolm Rifkind to finance the costs of the enterprise package in 1988-89.

On other remedial measures, I am grateful for Malcolm's assurances that any non enterprise company costs will be met from within his existing provision. And Nicholas Ridley has helpfully agreed that the costs of the Sunderland enterprise zone are to be met from within his programme. I am grateful for this and would only wish to note that the scale of the enterprise zone would need to proportionate to the scale of redundancies. Any substantial continuing activity at NESL should lead to a lower call on his programmes. Similarly, the current advance factory provision for Sunderland envisages complete or near complete closure of NESL. We might need to revisit this issue again in the (seemingly unlikely) event of substantial continuing shipbuilding activity at NESL.

I am copying this letter to the Prime Minister, David Young, Malcolm Rifkind, Tom King and Nicholas Ridley and to Sir Robin Butler.

*Yours Ever,*  
*John Major*

JOHN MAJOR

SECRET



CC:  
 PS/Chancellor  
 Mr Anson  
 Mr Monck  
 Mrs Burgner  
 Mr Moore  
 Miss Peirson  
 Mr Turnbull  
 Mr A M White  
 Mrs M Brown  
 Mr Waller  
 Mr Richardson  
 Mr B H Potter  
 Mr S Wood  
 Mr Romberg  
 Mr Call

Treasury Chambers, Parliament Street

The Rt Hon Kenneth Clarke QC MP  
 Chancellor of the Duchy of Lancaster  
 Department of Trade and Industry  
 1 - 19 Victoria Street  
 London  
 SW1

*[Handwritten signature]*  
 17<sup>th</sup> May 1988

**BRITISH SHIPBUILDERS: FINANCING REMEDIAL MEASURES**

Thank you for your letter of 6 May 1988. I am also replying to Malcolm Rifkind's letter of 9 May and to Nicholas Ridley's of 20 April.

I am pleased that you have felt able to accept my suggestion that the cost of remedial measures in future years should be decided in the Survey. That should enable us to take a well informed view of priorities.

As for 1988-89, I note from your letter that you feel we had agreed to split the 1988-89 costs of remedial measures, with your programme bearing the costs of advanced factory provision and the Reserve meeting the cost of the enterprise package. Clearly there has been some misunderstanding between us. My approach to this issue assumed that the great bulk of the £7½ million advanced factory provision endorsed by colleagues would fall in the current year and that you were offering to meet these sums from your existing provision, leaving only the financing of the 1988-89 costs of the enterprise package to be discussed between us.

As your letter makes clear, the 1988-89 costs of remedial measures are now much smaller than originally agreed with advanced factory provision of only some £2 million and an enterprise package costing £3.75 million (including provision for measures for Scotland and Bideford which have not been discussed or formally agreed). This compares with a potential claim on the Reserve of perhaps

*[Handwritten initials]*

CONFIDENTIAL



FROM: ZOE<sup>"</sup> EVEREST-PHILLIPS

DATE: 18 May 1988

*[Handwritten signature]*

MR SHARRATT

- cc:
- Chancellor
- Paymaster General
- Financial Secretary
- Economic Secretary
- Sir Peter Middleton
- Mr Anson
- Mr H Phillips
- Mr Monck
- Miss Peirson
- Mrs Brown
- Mr White
- Mr Bradley
- Mr Inglis
- Mr Call

SHORT BROTHERS

The Chief Secretary has seen your note of 16 May. He has commented that this news is appalling and would be grateful if you would seek the full details as soon as possible.

*[Handwritten signature]*

ZOE<sup>"</sup> EVEREST-PHILLIPS

Assistant Private Secretary



may25

FROM: A M WHITE  
DATE: 18 MAY 1988

PS/FINANCIAL SECRETARY

cc PS/Chancellor  
Mr Monck  
Mr Sharratt  
Mr Call

1 ~~Monck~~  
2 ~~prop~~

**MACKIES**

A point that the Financial Secretary may like to have in mind for his meeting this afternoon with Mr King is that in effect, if not in form, the latest proposals on Mackies are much closer to Mr King's original proposal of acquisition than to the arms length secured loan option that E(A) asked should be explained.

2. The proposals would:-

- (a) enable the Government to insist on management changes;
- (b) secure a 'non recourse' agreement with the principal creditor, the Northern Bank;
- (c) sustain Mackies operations and direct the development of the firm by requiring investment in approved facilities and plant;
- (d) prevent the Trustees from disposing of the company without the Government's agreement;
- (e) ensure that the bulk (over 85%) of the proceeds from any eventual disposal accrue to Government;
- (f) place Government very much at risk of having to meet Mackies liabilities in the event of failure.

Am unkind man would describe the present proposals as nationalisation by the back door - although in form the company would remain the Trusts property.

3. The proposals, which may indeed be the best way of rescuing Mackies were that to be done, fit neither with the E(A) remit nor the general thrust of Government policy.



A M WHITE