

PO-CH / NL / 0314

PART A

Part - A.

**SECRET**

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COMMERCIAL - IN - CONFIDENCE

Begins: 21/10/86.  
Ends: 17/11/87.

  
 PO -CH /NL/0314  
  
 PART A

Chancellor's (Lawson) Papers:

THE FINANCIAL POSITION  
 OF BRITISH SHIPBUILDERS

DD's : 25 Years

*PA added*

25/10/95.

PO -CH /NL/0314  
PART A

1. Tony  
2. Bif with advice



DEPARTMENT OF TRADE AND INDUSTRY

1-19 VICTORIA STREET  
LONDON SW1H 0ET

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From the Minister of State for Industry

GILES SHAW MP

The Rt Hon John MacGregor MP  
Chief Secretary  
H M Treasury  
London  
SW1

CHIEF SECRETARY	
REC.	MP 21 NOV 1986
TO	Mr Colman
	EX EST Sir Peter Middleton
	Mr Butler Mr Moran
	Mr Burgess Mr Gilmore
	Mr Moore Mr Scholer

21 November 1986

See John Mr Turnbull Mr Cropper Mr Tynne

BRITISH SHIPBUILDERS BORROWING POWERS ORDER 1986

British Shipbuilders' EFL was revised in June with your agreement to take account, among other things, of the costs of the restructuring measures being undertaken by the Corporation this year. I regret I must now warn you that the limit of £1300 is likely to be breached.

The prime cause of this impending breach is a default on instalments payments due to BS by International Transport Management (Offshore) Limited (ITM), now in Receivership. This will entail an unexpected loss in income for BS of about £45m this year.

It is also possible that the Corporation's cash requirements will be further significantly swelled by the failure of Jebsen of Bergen, now in severe financial difficulties, with whom British Shipbuilders have guarantees in place amounting to £28m.

Furthermore although the formal EFLs specifically excluded any additional costs this year arising from the sale of Scott Lithgow Limited, BS are now likely to be faced with further payments of around £32m.

My officials are discussing with British Shipbuilders possible areas in which compensating savings might be made within the EFL, and I will be discussing this and other matters with Phillip Hares on 1 December after his return from the Far East on business. Thereafter I should be better placed to advise you on the



consequences for the EFL and Supplementary Estimates. However, though options for the Corporation as a whole may be somewhat clearer by the beginning of December, the fate of the long awaited orders from China and Cuba will not, it is now clear, be known until the New Year. Failure on either order will, I suspect, be the occasion for us to examine the future of the business collectively, as we anticipated for the Autumn at the time of the Corporate Plan.

One immediate consequence of the ITM Receivership is the effect on the Corporation's statutory borrowing limit. On current estimates, BS will reach the present limit of £1300m set by the 1986 Borrowing Powers Act by 15 December. Unwelcome though this is, I have had no choice but to put in train the necessary arrangements to increase the Corporation's power to borrow far earlier than was anticipated when this Bill went through earlier this year.

*Yours  
Giles Shaw*

GILES SHAW

SHIPBUILDING

BIF with advice



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From the Minister of State for Industry

GILES SHAW MP

The Rt Hon John MacGregor  
Chief Secretary  
H M Treasury  
Parliament Street  
London  
SW1P 3AG

SECRETARY	
REC.	- 8 DEC 1986
TO	Mr Colman
FROM	CX FST MST EST
	Sir Peter Middleton
	Mr Butler Mr Monk
	Mr Burgess Mr Gilmore

8 December 1986

Mr Moore Mr Scholten  
Mr Turnbull Mrs Brown  
Mr Gray Mr Cropper Mr Tyrie

Dear John

FINANCIAL POSITION OF BRITISH SHIPBUILDERS

In recent weeks it has looked increasingly likely that British Shipbuilders will not succeed in living within their External Finance Limit this year. I must now tell you that the £130m limit will certainly be breached. Most of the likely breach is the result of events outside the control of BS: principally the Receivership of International Transport Management (Offshore) Ltd (ITM) and the expected worsening of difficulties faced by Jepsen's of Norway.

ITM had ordered a large craneship from North East Shipbuilders with a final contract price of £54m. The work is almost complete, but only £2m has actually been paid, and last year's accounts provided for a loss of only £4m on the contract. The financing of the bulk of the purchase price was not in place by the time the Receivership was appointed. The position is somewhat retrieveable, though probably not with effect on this year's EFL.

Second, BS built four ships for Jepsen of Norway in the late 1970's and early 1980's, and the Corporation has trade guarantees of £28m in total outstanding on these ships. Jepsen's poor performance recently means that the company's bankers will almost certainly press BS to join in a reconstruction of its finances involving the conversion of £18m of the £28m guarantee into unsecured loans. This is expected before the end of the financial year. The result



would be a call of a further £18m on cash this year, but if BS did not consent in circumstances in which Jebsen's would otherwise fall, the full £28m guarantee would be called. Since the Corporation's total exposure would not be increased, I believe they should take part as necessary if such a reconstruction occurs.

These two events, together with a worsened trading performance, mean that the outturn against the EFL is likely to be some £214m instead of the £130m limit, which already excluded the effect of the settlement of the Scott Lithgow completion accounts. These are now likely to have to be paid this financial year. No exact figure is yet available, but the estimate is £32m of which £10m has been already paid. Although outside the EFL, the payment to Trafalgar House nevertheless impinges heavily on BS' cash needs.

The ITM Receivership combined with the effect on delays in orders are the immediate reason for our seeking to raise BS's Borrowing Limit by £100m in the House on 8 December. I am very conscious that this increase follows hard on the Reels of a similar increase in the early summer, but we have no alternative if BS is to remain in business beyond the end of the year.

As regards BS' cash needs, my officials have agreed with British Shipbuilders that it would be appropriate to control the Corporation for the time being under a finance limit of £155m excluding Jebsen's and ITM. Based on the recent monitoring exercise involving our officials, this limit assumes that BS will be successful in selling an offshore support ship which has been completed at Ferguson to Arctic Offshore for £5m. This customer has also been in grave difficulty.

Other pressures on the EFL (to the extent of nearly £30 million) have been caused by delays in securing contracts and by performance on current contracts. Mr Hares' new monitoring arrangements are beginning to have effect but I have stressed to him the need to make further progress and have reminded him of the Contract Support Limit discipline, against which contract losses count. In response, Mr Hares noted that, since he is now very much in charge of marketing, he has the opportunity to approve contract prices and is in a position to moderate the optimum which can necessarily creep in when the order position is desperate and estimators are themselves aware that their jobs are far from secure.

My officials have also pressed BS to analyse their figures and see whether any of the forecast cash position can be clawed back on disposals, capital expenditure and creditors. The scope is very limited on disposals and BS have assured my officials that there is



no such scope for reduction in capital expenditure and creditors taking 1986/87 and 1987/88 together, though there could be a limited opportunity for rephasing.

I must say something about the cash position in tonight's Debate. I understand that you are not yet ready to agree on a revised EFL because of the major uncertainties on Jebson and ITM. I therefore propose to say that the EFL will be revised formally once we are clearer some of the major uncertainties arising from problems with their clients, notably ITM, are to be resolved; and that in the meantime we have introduced a firm limit of £155m on the external financing needs of the continuing business.

As regards ITM, BS have principally been engaged thus far in securing their legal title to the ship and its crane against aggrieved creditors of ITM. But they have had quite extensive preliminary discussions with partners who might be interested in acquiring the vessel on a distress basis or in operating it in some relation with BS. The Corporation has identified four options as follows:

- (i) cease work on the ship and scrap it
- (ii) complete the ship and try to sell it quickly ("distress" sale)
- (iii) complete the ship and sell it when - and if - the market improves
- (iv) complete the ship, form a company with new partners to operate and prove it as a "going concern", and seek to transfer equity to the trading partners for a value well in excess a distress sale.

BS have made no recommendations thus far except to establish, to my satisfaction, a case for completing the ship. They would save £10m completion costs by stopping work, and the scrap value would only be £2-5m. Against this, both the offshore broker advising the ITM Receiver and the Offshore Supplies Office, believe the vessel should realise around £25m on a distress sale basis.

It is possible that moving from Option (ii) to Option (iii) might realise a higher price, but, since the prospects in the offshore market are so uncertain, I do not myself attach much importance to it.



The aim of Option (iv), however, would, be to attempt to raise the price by turning the craneship from an asset into a going concern with a trading record. BS have pointed out that a demonstration period could be beneficial, in view of the many technical innovations in the ship, if a robust trading company could be put together. But they are not yet in a position to make a recommendation in principle, never mind detail, as to the route they would wish to follow. As a safeguard, they may nevertheless proceed to acquire ITM Challenger Ltd, the company set up by ITM (Offshore) to own and run the ship for a nominal £100. This purchase would bring with it the offer of £40m Section 10 lending made to ITM, even the whole value of this loan might not be taken up. However, the loan, which BS might guarantee as in the relationship envisaged with ITM, should help to attract trading partners.

BS will not be ready to make recommendations until early in January. My plan will be to write to you again then. But I am mindful now of the complexities and risk of Option (iv) and would need to be convinced of its prospects for recovering a greater proportion of the losses on the table before I could give it my support. I note that the Department would have a continuing liability to pay interest support to the value of £5m if a Section 10 loan of £40m were involved instead of, say, £2.5m in connection with a distress sale if that also involved Section 10 lending. I also note that, depending upon the timing and nature of the financial arrangements for the sale, there could be some recovery against the EFL this year.

A handwritten signature in black ink, appearing to read 'Giles Shaw', written in a cursive style.

GILES SHAW



CONFIDENTIAL

FROM: C A JONES  
9 December 1986

1. MR COLMAN  
2. CHIEF SECRETARY

1 copy  
J. G. C. 9/12

cc Chancellor  
FST  
Sir P Middleton  
Mr Butler  
Mr Monck  
Mr Burgner  
Mr Gilmore  
Mr Moore  
Mr Scholar  
Mr Turnbull  
Mr Cropper  
Mr Tyrie

### FINANCIAL POSITION OF BRITISH SHIPBUILDERS

Mr Shaw's letter to you of 21 November warned that British Shipbuilders (BS) were likely to significantly overshoot their EFL. His further letter of 8 December confirms that this is now unavoidable. At present, DTI's best estimate is that BS will need around £214m of external finance this year (not including £32m from the Scott Lithgow arbitration settlement, see below). This compares with a present EFL of £130m which has already been raised twice from its original £73m level. A provision of £59m was included in the PEWP figuring in respect of an overshoot of BS' EFL but the situation has deteriorated further since then. No provision was included in the Autumn Statement. The additional borrowing which BS will require has led to the need for an order to be laid under the British Shipbuilders' Borrowing Powers Act which raises their borrowing limit by £100m. This was debated in the House last night.

### REASONS FOR THE OVERSHOOT

2. There are four separate reasons for the overshoot. Firstly, the recent receivership of ITM (Offshore) Ltd means that about £35m of instalment payments expected during 1986-87 will no longer be received. ITM had an order with BS for a crane-ship which is now largely completed. The size of the effect on BS' external finance requirements in 1986-87 will depend on which of the four options outlined in Mr Shaw's letter BS pursue. If they cease work on the ship and scrap it, the total loss could be in the region of £26-29m. If they complete the ship, the loss would rise to £41m but there would be the prospect of a 'distress'

sale in 1987-88 which might raise around £25m. Alternatively, BS could complete the ship and then try to sell it for a better price or even operate the vessel themselves for a while. The costs of these options are not yet known. We should take a very sceptical line over BS' proposal to operate the vessel in conjunction with trading partners as we think that they should concentrate their effort on managing their own business, yet alone a new one, and the North Sea market is, at present, in a very depressed state. Whether the loss from the ITM Challenger is funded through Public Dividend Capital or Section 10 grants is, from a public expenditure point of view, largely irrelevant. BS hope to make recommendations on the future of the vessel early in January.

3. Secondly, BS still retain liability for financial guarantees of Jebsens, a Norwegian shipowner, worth £28m, which are likely to be called in part following Jebsens' collapse. Provision of £18m for the likelihood that this guarantee would be called was made in last year's Accounts, and it seems likely that the cash consequence this year may be precisely that amount. The ships to which these guarantees relate were delivered to Jebsens over 2 years ago.

4. Thirdly, following the judgment of the independent expert in the dispute between British Shipbuilders and Trafalgar House over the Scott Lithgow settlement, BS expect to be required to pay a total of over £30m before the end of the year. These payments relate to the cost of finishing the oil rig which Trafalgar House took over responsibility for when they acquired Scott Lithgow in 1984. Ministers have agreed that payments under the Scott Lithgow settlement would be outside the formal EFL, counting instead as an EFL overshoot, but the public expenditure effect is, of course, the same.

5. Finally, slippage in the orders which BS hoped to obtain earlier in the year has led to lower cash receipts than expected. In particular, the possible orders for ships from China and Cuba included in the Corporate Plan have yet to be secured, and although both orders are still being pursued, neither seems closer to a firm commitment than they did in July. Also further losses

are now expected on the contract for the Oldendorff ships due to defects in one of the completed ships which are having to be rectified in West Germany and delays in completing the other vessel, due to a strike at the Austin & Pickersgill Yard which shop stewards are refusing to discuss before 17 December. As Mr Shaw notes, losses of nearly £30m have been caused by these delays in securing contracts and by poor performance on current contracts.

#### **SCOPE FOR SAVINGS**

6. Mr Shaw accepts that there may be some scope for rephasing capital expenditure and creditors which, according to DTI officials, could produce benefits in 1986-87 worth £2m and up to £5m respectively. DTI officials have argued against this on the grounds that this rephasing would merely make BS' position in 1987-88 worse by an equal amount. There are two arguments for this rephasing. Firstly it would seem sensible to delay as much capital expenditure as possible since the future of BS is so uncertain. Even DTI and the BS Board accept that the Govan yards would become completely unviable if they fail to win the Brittany Ferry order and no orders from China materialise. Secondly, the slippage of receipts from 1986-87 into 1987-88 should improve BS' position in the second year whilst increasing their losses in 1986-87. This could be counterbalanced somewhat by a rephasing of creditors. The total public expenditure positions in 1986-87 and 1987-88 would also need to be considered.

#### **FINANCIAL CONTROL OF BS IN THE REST OF 1986-87**

7. The present EFL of £130m is clearly no longer an effective control on BS. However, it will be impossible to set a meaningful new EFL until it has been decided what to do with the ITM Challenger, hopefully early in January. The Contract Support Limit, which limits the amount of new, loss-making business taken on by BS, has also ceased to be an effective control since the

ministerial decision in July to relax these controls to allow BS a chance to win the orders on which their Corporate Plan was based. Thus, Mr Shaw announced in the House last night a firm limit of £155m on the external financing needs of the continuing business (ie excluding ITM, Jebsons and Scott Lithgow). Your agreement to this figure was not requested. The £155m is reasonable but makes no allowance for savings from the rephasing of capital expenditure and creditors. In practice, if orders and deliveries continue to slip, BS will probably fail to achieve even this target.

### RECOMMENDATION

8. Our objectives are as follows:

- i. ensure that BS decide on the most cost-effective solution for the ITM Challenger and as quickly as possible;
- ii. press them to achieve whatever savings are possible;
- iii. set a new EFL as quickly as possible and at a level consistent with a satisfactory outcome for (i) and (ii); and
- iv. E(A)'s discussion of the future of BS originally scheduled for this autumn, should take place as a matter of urgency.

9. The attached draft reply makes our position clear on these first three points. However, the timing of an E(A) discussion is somewhat more problematic. By early January, the future of the ITM Challenger should be known, and discussion could usefully take place concerning the control of BS for the rest of 1986-87 and the future of the business at its present level. However, it may be preferable to wait until after the next meeting of the BS Board at the end of January when the position regarding the Brittany Ferry order and possibly the Chinese and Cuban orders should be known. Should BS fail to win the Brittany Ferry order,

they accept that the Govan shipyard, one of the two major remaining yards, would probably have to close as would the Clark Kincaid yard at Greenock, the only remaining marine engine-building facility. The future of the corporation itself would be in question. There is no question but that an urgent ministerial discussion of the future of BS would have to take place if they fail to win the Brittany Ferry order, even if there had already been recent discussion. Also, the timing of the decision on the order may well slip as in many previous cases. Therefore, I think we are justified in requesting an E(A) discussion of BS' future early in February whatever the position on the Brittany Ferry order.

C A JONES

Encs

CONFIDENTIAL

D R A F T letter

FROM: CHIEF SECRETARY

TO: GILES SHAW Esq MP  
Minister of State for Industry

FINANCIAL POSITION OF BRITISH SHIPBUILDERS

Thank you for your letters of 21 November and 8 December concerning the breach of British Shipbuilders' (BS) current EFL of £130 million.

2. This is extremely disappointing news and it raises again the question of the cost in public expenditure terms of supporting what is, after all, a relatively small industry. When we took decisions in E(A) in July on BS' Corporate Plan, we decided to look again at the future of the business in the autumn in the light of developments on the various orders which were then being negotiated. Since BS' financial position has deteriorated so greatly recently, I would like to suggest that we fix a firm date for collective consideration of the future of the business some time early in the New Year, irrespective of the fate of any particular orders. I hope that you can agree to this.

**CONFIDENTIAL**

3. In the meantime, I hope that you will urge BS to consider as quickly as possible the most cost-effective option for the future of the ITM Challenger and the scope for possible savings. Given that the future of some yards, especially Govan and Greenock, is so uncertain, I think there is a good case for delaying capital expenditure wherever possible. Also, since the slippage of receipts is worsening BS' position in 1986-87 but improving it in 1987-88, I think the rephasing of creditors would be justified to counterbalance this somewhat. When we are clearer on the costs of the ITM Challenger and the scope for savings, we will need to agree a new EFL for BS as quickly as possible. Until then, I am sure that you will impress on Mr Hares the need for BS to at least stay within the limit of £155m on the external financing needs of the continuing business which you announced in the House last night.

**[JOHN MacGREGOR]**



PUP

P.P.S. in 2

FROM: M C FELSTEAD

DATE: 10 December 1986

MR COLMAN

cc:  
Chancellor  
Financial Secretary  
Sir Peter Middleton  
Mr F E R Butler  
Mr Monck  
Mr Burgner  
Mr Gilmore  
Mr Moore  
Mr Scholar  
Mr Turnbull  
Miss Cund  
Mr C A Jones  
Mr Cropper  
Mr Tyrie

**FINANCIAL POSITION OF BRITISH SHIPBUILDERS**

This is to record our brief discussion of Mr Jones's minute of 9 December to the Chief Secretary on BS's EFL.

2 I mentioned that the Chief Secretary regarded the present situation as appalling. He had asked how BS's troubles would affect the Reserve, and also their chances of winning the St Helena ship order. In addition, the Chief Secretary had queried whether the Treasury should have been consulted before Mr Shaw's announcement in the House on 8 December of a firm limit of £155 million on the external financing needs of BS, and whether he should say so in his reply to Mr Shaw. You said you did not believe there was a case for this and on that basis I sent the letter to Mr Shaw. You agreed to provide an explanatory note covering these points, in consultation with GEP and AEF.

**M C FELSTEAD**

Assistant Private Secretary





Treasury Chambers, Parliament Street, SW1P 3AG

Giles Shaw Esq MP  
Minister of State for Industry  
Department of Trade and Industry  
1 - 19 Victoria Street  
London  
SW1H 0ET

10 December 1986

*Dea Ministe,*

#### FINANCIAL POSITION OF BRITISH SHIPBUILDERS

Thank you for your letters of 21 November and 8 December concerning the breach of British Shipbuilders' (BS) current EFL of £130 million.

This is extremely disappointing news to say the least and it raises again the question of the cost in public expenditure terms of supporting what is, after all, a relatively small industry. When we took decisions in E(A) in July on BS' Corporate Plan, we decided to look again at the future of the business in the autumn in the light of developments on the various orders which were then being negotiated. Since BS' financial position has deteriorated so greatly recently, I would like to suggest that we fix a firm date for collective consideration of the future of the business some time early in the New Year, irrespective of the fate of any particular orders. I hope that you can agree to this.

In the meantime, I hope that you will urge BS to consider as quickly as possible the most cost-effective option for the future of the ITM Challenger and the scope for possible savings. Given that the future of some yards, especially Govan and Greenock, is so uncertain, I think there is a good case for delaying capital expenditure wherever possible. When we are clearer on the costs of the ITM Challenger and the scope for savings, we will need to agree a new EFL for BS as quickly as possible. Until then, I am sure that you will impress on Mr Hares the need for BS to at least stay within the limit of £155 million on the external financing needs of the continuing business which you announced in the House on Monday night.

*Yours sincerely,*

*John MacGregor*

PP JOHN MacGREGOR



b/f with  
response  
(or 2/1) (A)

10 DOWNING STREET  
LONDON SW1A 2AA

From the Private Secretary

18 December 1986

Dear Tony,

I attach a copy of a letter the Prime Minister has received from The Hon. W. G. Runciman.

I should be grateful if you could provide a draft reply, for the Prime Minister's signature, to reach me by 2 January.

I am copying this letter to Jonathan Cunliffe (Department of Transport).

Yours,  
David  
DAVID NORGROVE

CH/EXCHEQUER	
REC.	19 DEC 1986
ACTION	Mr Revolta
COPIES TO	EST, FST, Sir P Middleton, Mr FER Butler, Mr Anson, Mr Goldmore, PS/IR, Mr Cropper

Tony Kuczys, Esq  
H M Treasury

PRESIDENT:  
THE HON. W.G. RUNCIMAN  
Telephone 01-283 2922

GENERAL COUNCIL OF BRITISH SHIPPING

30-32 ST. MARY AXE  
LONDON, EC3A 8ET

16th December, 1986

The Rt. Hon. Margaret Thatcher, MP.,  
The Prime Minister,  
10, Downing Street,  
London, S.W.1.

PLS.

RWB

Dear Prime Minister,

THE MERCHANT NAVY

I am writing to you again on behalf of the British shipping industry in the wake of John Moore's recent address to us and the private meeting which a number of us had subsequently with Nigel Lawson.

You will be aware that there has been considerable discussion between the industry and the Department of Transport about the decline of the merchant fleet, the reasons for it, and the remedies which Government might adopt. You will also be aware that we have not entered these discussions in order to seek favours for our commercial interests but purely because we were and are convinced that, if all our activities are to be progressively transferred abroad, a strategic national resource will be irretrievably lost. Our members have no need for hand-outs in order to earn an adequate return for their shareholders by either switching their investments out of ships or by building, manning, operating and indeed owning their ships abroad. As I have said more than once in public since becoming President of the GCBS, this development matters much more to Britain than to the British shipping industry.

It is now clear to us from what we know of our members' intentions and forecasts that the number of flagged-out ships which could be recalled in an emergency will progressively decline, either because the ships are scrapped or sold or because they are re-flagged to more distant registries where further operational savings are available. John Moore's initiative will, we hope, help to keep a few more ships under the British flag than would otherwise be the case and to support the number of trained British seafarers available to be called on. But this is no more than a palliative; and meanwhile, investment in new ships will only in exceptional cases be for British or dependency register because of the much more favourable fiscal and other treatment of ships owned elsewhere. Quite apart from the obvious implications for defence and resupply, the effect on the overseas sea-trading invisibles account must also be a cause for serious concern.

Nigel Lawson told us on Friday that if help is needed to maintain a merchant fleet of sufficient size for national defence requirements, he would expect it to be provided by public expenditure from the Ministry of Defence, or possibly the Department of Transport, rather than by capital allowances specific to ships (which could be coupled with conditions designed to keep British-owned ships on registries where they would be available in time of need). I have to say

frankly that we find this argument astonishing. Capital allowances help efficient and profitable companies to invest, and they do so more cheaply, more efficiently and more consistently with your Administration's own free market principles than would cash subsidies found out of the Departmental Estimates. Moreover, the consequences of the Chancellor's preferred alternative are all too clear from the example of the United States; heavy cost, reduced efficiency and serious distortion of the commercial market.

I am sorry that I feel it my duty to write to you in these terms, particularly since there are many other areas where we find your Administration's policies both pragmatic and useful. But I most seriously urge you to consider pragmatically the case we have presented to the Chancellor for action in his next Budget and to ensure that it is not disregarded either for irrelevant reasons of Departmental accounting or because of unnecessary and easily containable fears of wider repercussions in the taxation field.

Yours truly

W. D. Brown



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CH/EXCHEQUER	
REC.	18 DEC 1986 R/12
ACTION	CST
COPIES TO	

PRIME MINISTER

BRITISH SHIPBUILDERS

When we decided in July to accept British Shipbuilder's Corporate Plan for the next two years - seeking to avoid further closures and redundancies once those just announced had worked through - it was clear that serious problems would arise if not all the forecast orders were won.

2 With two major yards remaining, Govan on the Clyde and North East Shipbuilders on the Wear, BS were looking for a series of small ferries for Denmark and a series of cargo ships for Cuba with North East Shipbuilders principally in mind, and a large ferry and a series of container ships for China for Govan. The Corporate Plan envisaged that all these orders would be taken, and we believed we should know the position on all of them this autumn.

3 In practice, only the Danish order, now for 25 small ferries, has actually been secured. This will keep North East Shipbuilders reasonably well loaded until well into 1989, but the order from Cuba, if it is to be secured at all, will now be smaller and has been delayed by that country's economic difficulties.

4 Far less certain is the future of Govan, where BS still hope to win a large ferry order from Brittany Ferries and the series of container ships from China. The present orderbook runs out at the end of March with the completion of the Norsesea ferry for P&O.

DWLCIX



5 Following discussion with his Board, Phillip Hares has recommended, and I agree, that during the next two months, BS should continue to do all in their power to win new work for Govan, but they plan to review the position at the end of January. They should then know whether the Brittany Ferry has been secured, and should be far better placed to judge where they stand on China. If the Brittany Ferry was lost, and the China orders still uncertain, Mr Hares says his Board would be likely to recommend on a commercial basis that a decision in principle should be taken to close the yard as soon as the Norsea was complete. No announcement would be made until the ship was handed over and the recommendation would be subject to work being secured in the interim. I intend to report further to colleagues following the BS Board meeting at the end of January.

6 In determining their approach, the BS Board took a careful look at the options for Govan. They do not believe the underlying market for shipbuilding offers a significant enough prospect to justify mothballing the yard after the completion of the Norsea, and they rule out the partial closure of NESL, moving some of the Danish ferries to Govan, as a cost effective alternative. I believe this analysis is correct.

7 If Govan were to be closed, the Corporation's ability to take the Chinese orders would not be in danger : these ships could be built at Sunderland.

8 There are only two other immediate prospects for Govan. The first is for the conversion of the two P&O ferries which might be placed around the end of this year. BS would undertake these at Govan but, like P&O, would see the few months work they provide as under-pinning the timely delivery



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of the Norsesea, not as justification for keeping Govan open beyond their completion in the absence of other work.

9 The second is the £19m passenger and cargo vessel which is to be financed from the aid programme to replace HMS St Helena. With the agreement of Chris Patten and John MacGregor, Giles Shaw was able to announce in the Shipbuilding Debate last week that officials have identified the exact type of ship and that, if the St Helena Government agreed, the ODA would set in motion the competitive tendering arrangements for designing and constructing the new vessel in a British yard.

10 The contenders are likely to be Govan and Richards, a private sector yard at Lowestoft owned by Tate and Lyle. I do not wish to pre-judge the competition, although I hope the greater experience of Govan in building larger and complex ships would stand them in good stead even if their tender were somewhat more expensive. But I do believe it would be vital for Govan to have a chance to quote for the order as early as the Overseas Development Administration could allow.

11 In short, if new work is not found for Govan by the end of January we will be faced with difficult decisions. But BS is doing all it can to win further orders to save the yard and I and my Department are giving every possible support.

12 Phillip Hares has also warned that the future of Clark Kincaid at Greenock, BS's only remaining marine enginebuilding facility is also in question. Prospects for this site are heavily dependent on the success of the Brittany Ferry and China orders in particular.

DW1CIX



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13 The delay in obtaining new work and the Receivership of International Transport Offshore Limited, for which BS is building a major crane barge, together with other factors, have led to a large increase in British Shipbuilders' cash requirements and loss forecasts this year.

14 The Corporation announced on 12 December a £51m half year loss, and they now forecast a £100m loss for the year.

15 Phillip Hares has been taking action to stem these losses and this is beginning to take effect, but Giles Shaw has stressed to him the importance we attach to his further progress. We are not in a position to set a revised External Financing Limit until we are clearer about how some of the major uncertainties arising from the Corporation's clients, notably ITM, were to be resolved. The Chief Secretary has agreed, however, and Giles Shaw has announced in the House that we have introduced a firm financing limit of £155m on areas the Corporation could control.

16 One piece of good news is that BS have accepted an attractive offer for Smith's Dock. You will recall that the closure of this yard was announced by BS in May. The offer is from a consortium interested in using the facilities essentially for offshore work. BS consulted Giles Shaw about this, who agreed with the recommendation that the sale should be made. It has been made clear that intervention funding will not be made available for any merchant ships the yard may build. BS employed 1400 at Smith's Dock : the new consortium is hoping to employ 360 by the end of the first year.





CONFIDENTIAL

17 I am sending copies of this minute to the Chancellor of the Exchequer, the Secretaries of State for Foreign Affairs, Employment and for Scotland, to the Chancellor of the Duchy of Lancaster and to Sir Robert Armstrong.

A handwritten signature in black ink, consisting of a large, stylized 'P' followed by a 'C'.

PAUL CHANNON

17 December 1986

DEPARTMENT OF TRADE & INDUSTRY

DW1C1X

CONFIDENTIAL

FROM: J G COLMAN  
18 December 1986

CHIEF SECRETARY

Chancellor  
FST  
Sir P Middleton  
Mr F E R Butler  
Mr Monck  
Mr Burgner  
Mr Gilmore  
Mr Moore  
Mr Scholar  
Mr Turnbull  
Miss Cund  
Mr Hood  
Mr Hurst  
Mr Parkinson  
Mr C A Jones  
  
Mr Cropper  
Mr Tyrie

FINANCIAL POSITION OF BRITISH SHIPBUILDERS

This submission is for information only. It gives further information on points that you raised concerning Mr C A Jones' earlier submission of 9 December and alerts you to action that may be needed in the near future.

2. British Shipbuilders (BS) are now certain to overshoot their present EFL of £130m, which itself included a £57m claim on the reserve. The potential further claim has been included in full in GEP's latest assessment of the state of the Reserve, and is also allowed for in the overall PEWP planning total outturn figure.

3. The best estimate available at present is that BS' external finance outturn will be £245m (including the Scott Lithgow settlement), an overshoot of £115m. Of this claim on the Reserve, £10m, which relates to the Scott Lithgow Settlement, has already been approved by you (see Mr C A Jones' submission of 23 October). Thus, there is a potential further claim on the reserve of up to £105m. The final size of the claim on the Reserve depends crucially on which option is pursued for the ITM Challenger and whether any off-setting savings are achieved (see Mr C A Jones' submission of 9 December).

CONFIDENTIAL

4. What Mr Shaw announced in the debate on 8 December was not a new EFL. There was no need for him to seek formal Treasury approval. His concern was that pending the revision of BS's EFL, it might appear that DTI had simply given up attempting to control BS's finances. So he announced a limit of the external financing of BS's continuing business, as distinct from the, rather numerous, one-off expenses. We agreed at official level that it was good rather than otherwise for DTI to show that they were monitoring control, and were content with the figure.

5. BS' position might be improved slightly if they were to win the contract to build the new St Helena ship but this would not alter their present problems. This order is unlikely to be placed until September 1987 and it would not be worth keeping open the Govan Yard, where BS propose to build the ship, for this order even if BS were assured of winning it. In fact, Richards Shipbuilders, a private sector firm, will also be tendering for the contract and seem, at present, to be more likely to win the order. If the Govan Yard fails to win the Brittany Ferry order, then, it would still need to be closed. If BS were subsequently to win the St Helena order, they could still build it but at another yard.

FUTURE ACTION

6. We would not wish to agree a new EFL until early next year when the position regarding the ITM Challenger, the Jepsens' guarantee and the scope for savings is clearer. Once the EFL has been set, we will be able to agree the size of the Spring Supplementary that will be needed. Until the Spring Supplementary has been approved, BS will continue to meet their losses from borrowing within the public sector.

7. This submission has been cleared with GEP and AEF Divisions.

*C. A. Jones*

p.p. J G COLMAN

CONFIDENTIAL



10 DOWNING STREET  
LONDON SW1A 2AA

18 December 1986

From the Private Secretary

*See also paper below CR 19/1*

Dear Paul,

*if we are pushed to provide some form of assistance to Britain*

BRITISH SHIPBUILDERS

The Prime Minister has seen your Secretary of State's minute of 17 December about the position of British Shipbuilders. She has noted in particular that the prospects for Govan will be affected by how quickly the competition for a replacement for HMS Helena can be run. She has asked that the Overseas Development Administration should give a very high priority to getting this moving quickly.

*Support - 18m to result from CST attach a note BTA*

I am copying this letter to Alex Allan (HM Treasury), Colin Budd (Foreign and Commonwealth Office), John Turner (Department of Employment), Robert Gordon (Scottish Office), Andrew Lansley (Chancellor of the Duchy of Lancaster's Office) and Trevor Woolley (Cabinet Office).

*assistance*

Yours,  
David

David Norgrove

CH/EXCHEQUER	
REC.	18 DEC 1986
ACTION	CST
COPIES TO	

*12 This was the*

Paul Steeples Esq  
Department of Trade and Industry

*There is a realisation of a competition: we had to do it with a strategic head, but no more work*

*Don't forget to ask for assistance from the private sector for shipbuilding*

CONFIDENTIAL



FROM: CATHY RYDING  
DATE: 22 December 1986

PS/CHIEF SECRETARY

cc:  
PS/Financial Secretary  
Sir P Middleton  
Mr F E R Butler  
Mr Monck  
Mr Burgner  
Mr Gilmore  
Mr Moore  
Mr Scholar  
Mr Turnbull  
Mr Cropper  
Mr Tyrie

### BRITISH SHIPBUILDERS

The Chancellor has seen David Norgrove's letter to Paul Steeples of 18 December.

2. The Chancellor has commented that if we are pushed to provide some form of assistance to British Shipping - and he seems to recall that the Chief Secretary attended a recent E(A) at which this was a strong view - then we might insist on recouping it from the assistance we at present give to British Shipbuilding. There is in reality a connection: not only do we need to decide which is the greatest strategic need, but the more ships that are built at subsidised rates the worse the plight of British Shipping.

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

CATHY RYDING

FROM: JIM MILNER  
 DATE: 30 DECEMBER 1986

RP

- 1 MR GILMORE *✓* *1 agree* *30* *(Kin)*  
 2 PS CHIEF SECRETARY

cc PS Chancellor - 12/2  
 PS Financial Secretary  
 PS Economic Secretary  
 PS Minister of State  
 Sir Peter Middleton  
 Mr F E R Butler  
 Mr Cassell Mr Anson  
 Mr Scholar Mr S Robson  
 Ms Seammen Miss Sinclair  
 Mr Cropper Mr Driscoll IR  
 PS Inland Revenue

MERCHANT SHIPPING: CORPORATION TAX CAPITAL ALLOWANCES AND DEFENCE

1 The President of the General Council of British Shipping (GCBS) wrote to the Prime Minister on 16 December asking for the reintroduction of accelerated corporation tax capital allowances for ships to secure future defence needs. We are asked to suggest a reply by 2 January. I attach a draft.

Background

2 The President was prompted to write by the Chancellor's line, at lunch on 12 December, that he held out no prospect of reversing the 1984 Budget decision; if there was a case for subsidy it was for the Secretary of State for Defence to consider alongside his other priorities. (The Chancellor's Private Secretary's minute of 15 December records the point in paragraph 3.)

3 The Government have resisted repeated calls to reintroduce accelerated capital allowances for ships. The Prime Minister reaffirmed that view in her summing up of the E(A) discussion on 8 December that authorised discussions with the industry on three expenditure measures;

- i a merchant seamen reserve register (£1 million a year),
- ii Government financial support for training (up to £10 million a year), and
- iii Government financial support for flying replacement crews to and from UK ships overseas (about £10 million a year).

Incidentally, these measures will require legislation, expenditure could not begin till towards the end of 1988-89 at the earliest and would then take a couple of years to build up to the full estimate of £21 million a year. We will seek to have any costs met from within existing plans.

4 The decline of the merchant fleet is a sensitive issue and the Prime Minister will want to send a balanced reply.

Action

5 I suggest you send the attached draft reply which has been agreed with Inland Revenue and Department of Transport officials.

*Jim Milner*

JIM MILNER  
 HE1 x4722

Attached - Draft PM's reply  
 and draft PS covering letter

Letter from the Prime Minister to the Hon W G Runciman, President of the GCBS

MERCHANT SHIPPING: CORPORATION TAX CAPITAL ALLOWANCES AND DEFENCE

Thank you for your letter of 16 December asking for the reintroduction of accelerated capital allowances for ships.

The 1984 Budget decision to withdraw accelerated capital allowances to all businesses was part of a package designed to simplify corporation tax and to remove features of the system that distorted investment and other business decisions. At the same time we reduced the basic rate to 35 per cent, then the lowest in any major industrial nation. While we thought it right at the time to alter detailed points to meet individual industries' particular needs (flexible use of writing down allowances, for example), we remain convinced that we were right to get rid of 100 per cent first year allowances and the distortion of investment they led to.

Assistance to shipping by the restoration of front loaded allowances would be no more consistent with our free market principles than cash subsidies. I am concerned about the decline in the UK merchant fleet, and see the Government's main role as being to pursue vigorously international agreement against protectionism to allow free and fair competition. The measures <sup>which</sup> we did a great deal to promote, and which were agreed at the December European Community Transport Council, are significant progress.

*cases in point* → We keep defence and civil resupply needs under constant review. John Moore's recent announcement of consultation about a merchant seamen reserve register, and financial assistance for training and flying crews to and from ships, are intended to help ward off the potential problem of insufficient experienced men. We are also pressing for a review of the adequacy of shipping for the NATO civil supply pool. ~~But~~ We are far from complacent, and accept that we should plan against the possibility that future forecasts may suggest the need for further action. However, I am not persuaded that the restoration of accelerated capital allowances would provide a solution.

Private Secretary letter to David Norgrove, 10 Downing Street

MERCHANT SHIPPING: CORPORATION TAX CAPITAL ALLOWANCES AND DEFENCE

1 The President of the General Council of British Shipping wrote to the Prime Minister on 16 December asking for the reintroduction of accelerated capital allowances for ships to secure future defence needs.

2 The Government have resisted repeated calls to make a special case of merchant shipping and reverse the 1984 Budget decision. This line was most recently reaffirmed in the Prime Minister's summing up of the E(A) discussion on 8 December.

3 I attach a draft reply which has been agreed with Inland Revenue and Department of Transport officials.

4 I am copying this to Jonathen Cunliffe (Department of Transport).





8

i.c. Chancellor

FST MST EST

Sir Peter Middleton

Mr Butler Mr Anson

Mr Carrall Mr Gilmore

Mr Robson Mr Scholar

Treasury Chambers, Parliament Street, SW1P 3AG Ms Seaman

David Norgrove Esq  
Private Secretary  
10 Downing Street  
London  
SW1

Mrs Sinclair Mr Cooper

Mr Milner Mr Driscoll

PS/IR

31 December 1986

Dear David,

**MERCHANT SHIPPING: CORPORATION TAX CAPITAL ALLOWANCES AND DEFENCE**

The President of the General Council of British Shipping wrote to the Prime Minister on 16 December asking for the reintroduction of accelerated capital allowances for ships to secure future defence needs.

The Government have resisted repeated calls to make a special case of merchant shipping and reverse the 1984 Budget decision. This line was most recently re-affirmed in the Prime Minister's summing up of the E(A) discussion on 8 December.

... I attach a draft reply which has been agreed with Inland Revenue and Department of Transport officials.

I am copying this letter Jonathan Cunliffe (Department of Transport).

Yours sincerely  
M C Felstead

**M C FELSTEAD**  
Private Secretary

Reft letter from the Prime Minister

TO:

The Hon W G Runciman  
President  
General Council of British Shipping  
30-32 St Mary Axe  
London  
EC3A 8ET

**MERCHANT SHIPPING: CORPORATION TAX CAPITAL ALLOWANCES AND DEFENCE**

Thank you for your letter of 16 December asking for the reintroduction of accelerated capital allowances for ships.

The 1984 Budget decision to withdraw accelerated capital allowances to all businesses was part of a package designed to simplify corporation tax and to remove features of the system that distorted investment and other business decisions. At the same time we reduced the basic rate to 35 per cent, then the lowest in any major industrial nation. While we thought it right at the time to alter detailed points to meet individual industries' particular needs (flexible use of writing down allowances, for example), we remain convinced that we were right to get rid of 100 per cent first - year allowances and the distortion of investment they led to.

Assistance to shipping by the restoration of front - loaded allowances would be no more consistent with our free market principles than cash subsidies. I am concerned about the decline in the UK merchant fleet, and see the Government's main role as being to pursue vigorously international agreement against protectionism to allow free and fair competition. The measures agreed at the December European Community Transport Council, which we did a great deal to promote, are a significant progress.

We keep defence and civil resupply needs under constant review. John Moore's recent announcement of consultation about a merchant seamen reserve register, and financial assistance for training and flying crews to and from ships, are cases in point. We are also

pressing for a review of the adequacy of shipping for the NATO civil supply pool. We are far from complacent, and accept that we should plan against the possibility that future forecasts may suggest the need for further action. However, I am not persuaded that the restoration of accelerated capital allowances would provide a solution.

B/F with redru M.



10 DOWNING STREET

LONDON SW1A 2AA

From the Private Secretary

5 January 1987

CHIEF SECRETARY	
REC.	-6 JAN 1987
	Mr Milnes
	Mr Peter Muddler
	Mr Butler Mr Anson
	Mr Casell Mr Gilmore

Dear Max, Mr Robson Mr Scholar Ms Seaman  
Miss Sinclair Mr Cropper PS/IR M/Druell/IR

The Prime Minister has seen your draft reply to Mr. Runciman's letter of 16 December (attached to your letter of 31 December to me) and feels that it could be improved. She points out that the decline in the UK merchant fleet continued even while accelerated depreciation was allowed: it did not stop flagging out. The Prime Minister has asked for the draft to be re-written to make the case much more fully.

I should be grateful to receive a revised draft reply by close of business on Thursday, 8 January.

Jan,  
David

(DAVID NORGROVE)

M. C. Felstead, Esq.,  
HM Treasury.

RF

FROM: JIM MILNER  
DATE: 8 JANUARY 1987

- 1 MR REVOLTA *I agree. PR 8/1.*
- 2 PS FINANCIAL SECRETARY

- cc PS Chancellor
- PS Chief Secretary
- PS Economic Secretary
- PS Minister of State
- Sir Peter Middleton
- Mr F E R Butler
- Mr Cassell      Mr Anson
- Mr Scholar      Mr S Robson
- Mr Gilmore      Ms Seammen
- Miss Sinclair    Mr Cropper
- PS Inland Rev    Mr Driscoll

*I have missed the charge - "Prime Minister would be given £100m for the Inland Revenue, & for the Inland Revenue."*

MERCHANT SHIPPING: CORPORATION TAX CAPITAL ALLOWANCES AND DEFENCE

- 1 The President of the General Council of British Shipping (GCBS) wrote to the Prime Minister on 16 December asking for the reintroduction of accelerated corporation tax capital allowances for ships to secure future defence needs.
- 2 We are asked to suggest a reply today making more of the case against reversing the 1984 Budget decision. I attach a redraft prepared in consultation with the Inland Revenue.

*Phoned comment through to David Norgrove  
DJK  
9/1*

*Jim Milner*

JIM MILNER  
HE1 x4722

Attached - Draft PM's reply

*120/893*

## DRAFT LETTER FROM THE PRIME MINISTER

TO:

The Hon W G Runciman  
President  
General Council of British Shipping  
30-32 St Mary Axe  
LONDON EC3A 8ET

**MERCHANT SHIPPING: CORPORATION TAX CAPITAL ALLOWANCES AND DEFENCE**

Thank you for your letter of 16 December asking for the reintroduction of accelerated capital allowances for ships.

I note what you say about capital allowances helping efficient and profitable companies to invest and about them being both cheaper and more consistent with free market principles. There are, I think, two main points to be made here.

The first is that, although incentives to investment in both plant and machinery and industrial buildings had been available over virtually the whole of the post war period, available evidence suggests that these incentives have done little to achieve their purpose. Indeed, the indications are that, instead of strengthening the economy, businesses had invested in assets yielding a lower rate of return than investments made by our principal competitors. Nigel Lawson made this point when introducing his 1984 Budget. In that context, it is worth recalling that the decline in the UK merchant fleet began in 1975 when the high point of 52 million deadweight tonnes was reached and continued over the period when 100 per cent first year allowances were generally available to 22 million deadweight tonnes by 1984.

Within the overall framework of the 1984 business tax reforms, provision was made to allow greater flexibility in the use of writing down allowances with some of the changes applicable only to the shipping industry. The ability to take tax allowances at will (free depreciation) was adapted to the changed circumstances and extended to secondhand ships as well as new ships. But we remain convinced that we were right to get rid of indiscriminate up-front tax allowances and the distortion of investment to which they led in favour of a more neutral system based on significantly lower rates of tax and rates of allowances reckoned to be on average rather more generous than would be available under a strict system of commercial depreciation. Allowances at the rate of 25 per cent of the reducing balance provide an effective eight year writing off period which I would expect to be a good deal shorter than the normal life expectancy of a ship.

Secondly, I do not accept that the restoration of front-loaded allowances would be more consistent with our free market principles than cash subsidies. These also distort the free operation of the market. I am ~~concerned about~~ <sup>now different to</sup> the decline in the UK merchant fleet, and see the Government's main role as being to pursue vigorously international agreement against protectionism to allow free and fair competition. The measures agreed at the December European Community Transport Council, which we did a great deal to promote, are significant progress.

We keep defence and civil resupply needs under constant review. John Moore's recent announcement of consultation about a merchant seamen reserve register, and financial assistance for training and flying crews to and from ships, are cases in point. We are also pressing for a review of the adequacy of shipping for the NATO civil supply pool. We are far from complacent, and accept that we should plan against the possibility that future forecasts may suggest the need for further action. However, I am not persuaded that the restoration of accelerated capital allowances would provide a solution.





CC PPS PPSm

*Rud*

CST  
EST  
MST  
Sir P. Middleton  
Mr FER Butler  
Mr Cassell  
Mr Scholar  
Mr Gilmore  
Miss Sinclair  
Mr Anson  
Mr S. Robson  
Ms Seaman  
Mr Cropper  
Mr Driscoll  
P/S/R

Treasury Chambers, Parliament Street. SW1P 3AG

David Norgrove Esq  
Private Secretary  
10 Downing Street  
LONDON SW1A 2AA

8 January 1987

Dear David,

I am attaching a redrafted version of the reply for the Prime Minister to send to Mr Runciman of the General Council of British Shipping. This was requested in your letter of 5 January to Max Felstead.

Yours sincerely  
*Nigel Williams*  
NIGEL WILLIAMS  
(Assistant Private Secretary)

## DRAFT LETTER FROM THE PRIME MINISTER

TO:

The Hon W G Runciman  
President  
General Council of British Shipping  
30-32 St Mary Axe  
LONDON EC3A 8ET

**MERCHANT SHIPPING: CORPORATION TAX CAPITAL ALLOWANCES AND DEFENCE**

Thank you for your letter of 16 December asking for the reintroduction of accelerated capital allowances for ships.

I note what you say about capital allowances helping efficient and profitable companies to invest and about them being both cheaper and more consistent with free market principles. There are, I think, two main points to be made here.

The first is that, although incentives to investment in both plant and machinery and industrial buildings had been available over virtually the whole of the post war period, available evidence suggests that these incentives have done little to achieve their purpose. Indeed, the indications are that, instead of strengthening the economy, businesses had invested in assets yielding a lower rate of return than investments made by our principal competitors. Nigel Lawson made this point when introducing his 1984 Budget. In that context, it is worth recalling that the decline in the UK merchant fleet began in 1975 when the high point of 52 million deadweight tonnes was reached and continued over the period when 100 per cent first year allowances were generally available to 22 million deadweight tonnes by 1984.

Within the overall framework of the 1984 business tax reforms, provision was made to allow greater flexibility in the use of writing down allowances with some of the changes applicable only to the shipping industry. The ability to take tax allowances at will (free depreciation) was adapted to the changed circumstances and extended to secondhand ships as well as new ships. But we remain convinced that we were right to get rid of indiscriminate up-front tax allowances and the distortion of investment to which they led in favour of a more neutral system based on significantly lower rates of tax and rates of allowances reckoned to be on average rather more generous than would be available under a strict system of commercial depreciation. Allowances at the rate of 25 per cent of the reducing balance provide an effective eight year writing off period which I would expect to be a good deal shorter than the normal life expectancy of a ship.

Secondly, I do not accept that the restoration of front-loaded allowances would be more consistent with our free market principles than cash subsidies. These also distort the free operation of the market. I am concerned about the decline in the UK merchant fleet, and see the Government's main role as being to pursue vigorously international agreement against protectionism to allow free and fair competition. The measures agreed at the December European Community Transport Council, which we did a great deal to promote, are significant progress.

We keep defence and civil resupply needs under constant review. John Moore's recent announcement of consultation about a merchant seamen reserve register, and financial assistance for training and flying crews to and from ships, are cases in point. We are also pressing for a review of the adequacy of shipping for the NATO civil supply pool. We are far from complacent, and accept that we should plan against the possibility that future forecasts may suggest the need for further action. However, I am not persuaded that the restoration of accelerated capital allowances would provide a solution.



SCOTTISH OFFICE  
WHITEHALL, LONDON SW1A 2AU

*B/F with adv*

The Rt Hon Paul Channon MP  
Secretary of State for Trade and Industry  
1 Victoria Street  
London  
SW1H 0ET

CH/EXCHEQUER	
REC.	09 JAN 1987
ACTION	CST
COPIES TO	

8 January 1987

*Dear Paul,*

BRITISH SHIPBUILDERS

I have seen your minute of 17 December to the Prime Minister.

As you must anticipate, I am appalled at the prospect of losing Govan. Not only would this mean a further 1,800 redundancies in an area already facing major social and economic problems over industrial restructuring but also the loss of the last merchant shipyard of any consequence on the Clyde. Govan has been billed as the jewel in the British Shipbuilders crown. The impact of its loss on Clydeside and on the credibility of the Government's position in Scotland should not be underestimated. I am also concerned about the potential loss of Clark of Kincaid. I recognise that it depends for much of its work on orders from British Shipbuilders' yards but the loss of 500 jobs in Greenock would be another severe blow for the area.

Clearly, I entirely support the efforts to advance and secure for Govan the St Helena order. If this fails, and neither the Brittany Ferries nor Chinese orders materialise, we shall need to explore all other conceivable options for saving the yard.

I would be grateful if you would keep me in close touch with other developments.

Copies of this letter go to the Prime Minister, to Nigel Lawson, Geoffrey Howe, David Young and Norman Tebbit and to Sir Robert Armstrong.

*Yours ever,*  
*Malcolm Rifkind*

MALCOLM RIFKIND



*AP*

*28*

10 DOWNING STREET  
LONDON SW1A 2AA

THE PRIME MINISTER

12 January 1987

CH/EXCHQU	
REC.	15 JAN 1987 15/1
ACTION	FST
COPIES TO	

*Dear Mr. Runciman,*

Thank you for your letter of 16 December asking for the reintroduction of accelerated capital allowances for ships.

I note what you say about capital allowances helping efficient and profitable companies to invest and about them being both cheaper and more consistent with free market principles. There are, I think, two main points to be made here.

The first is that the available evidence suggests that the incentives to investment in both plant and machinery and industrial buildings - available over virtually the whole of the post war period - achieved little. Indeed, the indications are that, instead of strengthening the economy, businesses invested in assets yielding a lower rate of return than investments made by our principal competitors. Nigel Lawson made this point when introducing his 1984 Budget. In that context, it is worth recalling that the decline in the UK merchant fleet began in 1975 when the high point of 52 million deadweight tonnes was reached and continued over the period when 100 per cent first year allowances were generally available. The tonnage of the merchant fleet had fallen to 22 million by 1984.

I remain convinced that it was right to abolish indiscriminate up-front tax allowances and the distortion of investment to which they led in favour of a more neutral system based on significantly lower rates of tax. Even so, the present rates of allowances are reckoned to be on average rather more generous than would be available under a strict system of commercial depreciation. Allowances at the rate of 25 per cent of the reducing balance provide an effective eight year writing off period which is surely a good deal shorter than the normal life expectancy of a ship. Moreover, the 1984 tax reforms included provision to allow greater flexibility in the use of writing down allowances, and some of the changes were applicable only to the shipping industry. The ability to take tax allowances at will (free depreciation) was adapted to the changed circumstances and extended to secondhand ships as well as new ships.

Secondly, I do not accept that the restoration of front-loaded allowances would be more consistent with our free market principles than cash subsidies. These also distort the free operation of the market.

✓ I of course recognise the strength of the concern about the decline in the UK merchant fleet. But the main way in which the Government can help is to push as hard as we can for international agreement against protectionism, in the interests of free and fair competition. The measures agreed at the December European Community Transport Council, which the Government did a great deal to promote, were a significant step forward.

I can assure you that defence and civil resupply needs are kept under constant review. John Moore's recent announcement of consultation about a merchant seamen reserve register, and financial assistance for training and flying crews to and from ships, are cases in point. We are also pressing for a review of the adequacy of shipping for the NATO civil supply pool. There is no complacency, and it is accepted that we should plan against the possibility that

future forecasts may suggest the need for further action. However, I am not persuaded that the restoration of accelerated capital allowances would provide a solution.

Yours sincerely

Margaret Thatcher

---

The Hon. W.G. Runciman.





SECRET

CH/EXCHEQUER	
REC.	22 JAN 1987 ✓ 22/1
ACTION	CST
COPIES TO	

PRIME MINISTER

BRITISH SHIPBUILDERS

My minute of 17 December explained that the future of the Govan yard was most immediately linked with orders for a large ferry from Brittany Ferries and a series of container ships from China. Final commercial and technical negotiations with the Chinese have been delayed at their request to begin on 9 February. This minute records recent developments on the Brittany Ferry.

2 Before Christmas, the competition for the Brittany Ferry appeared to have narrowed to Govan and a Finnish yard. Early in January, Brittany Ferries told Govan that their offer was preferred. However, a French yard, Chantiers de l'Atlantique at St Nazaire in Brittany had sought a new opportunity to tender. French officials then contacted my Department to say they could not believe the offer by Govan was consistent with the terms of the new EC Directive on Shipbuilding Aid. I concluded the French Government was planning to frustrate the placing of the order with Govan.

3 I therefore wrote to M. Madelin, the French Minister for Industry, saying that the Govan price and conditions were fully consistent with the Directive, and explaining the vital importance for the order for the yard. Though he has yet to reply, M. Madelin's cabinet have given a very frank account of the position to our Embassy in Paris. It is plain from this the French are determined the order should go to St Nazaire. They refuse to believe the BS tender can be consistent with the Directive. And, besides M. Madelin having a Breton constituency, a key difficulty is that



SECRET

Brittany Ferries is largely dependent on regional public funds. BS have learned from Brittany Ferries and the yard that considerable pressure has built up in Brittany for a order to be placed locally.

4 In an atmosphere coloured by the recent public sector strikes and given the Breton dimension, the Embassy sees little chance of an approach elsewhere in the French Administration producing a different response. The Foreign and Commonwealth Office has confirmed to my officials that a further direct approach even at Prime Ministerial level cannot be expected to shift the French.

5 On a second front Giles Shaw has written to Peter Sutherland, the EC Competition Commissioner, explaining why the Govan offer is consistent with the new Directive, and inviting him to ensure its principles are fully applied in this case. Conveying the letter, Sir David Hannay explained that we believe the French could not legally undercut Govan. Sutherland told Sir David that he would follow the matter up immediately with the French.

6 Although we have no significant leverage in wider UK-French trade issues, it is open to us to put pressure on Brittany Ferries by the threat of instigating a full investigation by the Commission's Transport Directorate into their operating subsidies. We have begun to play this card, though I judge our main hope lies with Commissioner Sutherland.

JG2ARN



SECRET

7 I believe we are doing all we can to secure this order by my assessment is that the odds are against us. In this perspective, the China order and that for the St Helena vessel become all the more vital for Govan. The conversion work I also referred to on 17 December has, unfortunately, gone to Germany.

8 I will of course keep my colleagues posted on the position at Govan.

9 I sending copies of this minute to the Chancellor of the Exchequer the Secretaries of State for Foreign Affairs, Employment, Transport and for Scotland, to the Chancellor of the Duchy of Lancaster and to Sir Robert Armstrong.

Handwritten initials 'PC' in a cursive script.

PAUL CHANNON

22 January 1987

Department of Trade & Industry

JG2ARN

*Wooded  
Papers  
see below*

FROM: C A JONES  
DATE: 22 January 1987

*Agreed  
J.F.C. 22/1*

- 1 MR COLMAN
- 2 MR F E R BUTLER
- 3 CHIEF SECRETARY
- 4 and return to sender

- cc: Chancellor
- FST
- Sir P Middleton
- Mr Monck
- Mr Burgner
- Mr Moore
- Mr Scholar
- Mr Turnbull
- Mr Hurst
- Mr Parkinson
- Mr Hood
- Mr Buckler
- Mr Cropper
- Mr Tyrie
- Mr Ross Goobey

**SPRING SUPPLEMENTARY ESTIMATES 1986-87**

**CLASS V, VOTE 4 : GOVERNMENT INVESTMENT IN NATIONALISED INDUSTRIES**

This submission seeks your approval of a supplementary estimate of £113.044 million and the associated £102.044 million claim on the Reserve for British Shipbuilders (BS). A formal EFL change will be required soon. The policy issues involved were discussed in my earlier submission of 9 December and Mr Colman's submission of 18 December. You wrote to Giles Shaw on 10 December expressing your concern at the current position regarding BS. A copy of this letter and Giles Shaw's reply are attached. Basically, as long as the strategy agreed by E(A) in June 1986 of allowing BS to try to win as much work as possible is maintained in order to keep yards open, there is a continuing danger of further EFL overshoots. We understand that Mr Channon will be minuting the Prime Minister shortly on the prospects of BS winning a major order. We will submit further advice on BS's financial position in the light of that minute.

*attached*

*140 copy  
attached  
see what*

- 2. This vote finances Government support for BS consisting of Public Dividend capital payments, Intervention Fund grants to assist BS in competing with non-EC shipyards and grants to BS for redundancy payments. It is not treated as a cash limit.
- 3. The Supplementary implies a discretionary claim on the

Reserve of £102.044 million, which has been included in GEP's January assessment of the Reserve, and £11 million not involving any claim on the Reserve. This will reduce the level of market borrowing within BS' EFL. The scope for offsetting savings is discussed in paragraph 8 below.

4. The current voted provision will be exceeded by £113.044 million, an increase of 55 per cent.

5. Of the claim on the Reserve, £25 million arises from further difficulties with BS' continuing business, notably failure to win expected orders. Giles Shaw announced in the House of Commons on 8 December 1986 a firm limit of £155 million on the external financing of BS' continuing business, compared to an EFL at present of £130 million. (BS' original EFL for 1986-87 was £73m).

6. I warned in my submission of 9 December that BS were also likely to need large amounts of extra finance due to other factors beyond their control. Of these, it is now clear that BS will lose £41 million of income previously expected this year, due to the bankruptcy of ITM Offshore Ltd who had a vessel valued at £47.5 million on order from BS. It is also very likely, although not yet certain, that £18 million will be needed due to financial guarantees given some years ago to Jebsens, a Norwegian shipowner, which recently collapsed. £10 million has already been paid to Trafalgar House as part of the settlement of the Scott Lithgow dispute. BS still expect to have to pay another £22 million in 1986-87 to complete the settlement. It would be preferable for this money to be paid this year rather than in 1987-88 when it would come under the new EC Sixth Directive on aid to shipbuilding which sets a limit on the amount of aid that can be given to shipbuilders.

7. £66 million of extra finance for BS will definitely be needed. The remaining £40 million will probably be needed but will only be paid over to BS if these needs actually do arise.

8. BS' need for £106 million of extra finance is offset slightly by a reduced need for the Shipbuilding Redundancy Payment Scheme

of £3.956 million. Thus, the total claim on the Reserve is £102.044 million. There are no other opportunities for offsetting savings on the vote. Mr Buckler's submission of 21 January concerning the Supplementary on Class V, Vote 1 will discuss the scope for offsetting savings on other DTI votes.

9. We will be submitting shortly to seek approval for a formal increase in BS' EFL, even if it is still not known whether the Jebbens' guarantee will be called or not.

Recommendation

10. I recommend that you:

- (i) approve the attached Supplementary involving additional provision of £113.044 million;
- (ii) agree the related claim on the Reserve of £102.044 million.

11. GEP2 are content.

*Chris Jones.*

C A JONES

# Government Investment in Nationalised Industries

1. Expenditure borne on this vote is not subject to a cash limit.
2. Additional public dividend capital (PDC) is sought for British Shipbuilders to meet financing needs resulting from the additional costs this year of customer defaults and the effects of delays in securing new orders. To reduce the amount of PDC sought in this Supplementary a further £3 million has been vired from the provision for the public sector Intervention Fund to reflect grant that would have been paid to a company which has now gone into liquidation. There are savings from the Shipbuilding Redundancy Payment Scheme which ended on 31 December 1986.

## Part I

# £113,044,000

SUPPLEMENTARY amount required in the year ending 31 March 1987 for Government investment in British Shipbuilders, grants from the shipbuilding intervention fund to assist public sector yards and assistance to redundant shipyard workers.

The Department of Trade and Industry will account for this vote.

## Part II Summary and subhead detail

### Summary

Present provision		Changes proposed	New provision
£'000		£'000	£'000
23,030	4.3/4.4 Support for aerospace shipbuilding, steel and vehicle manufacture (Section A)	-3,956	19,074
180,696	4.13 Nationalised Industries external finance (Section B)	117,000	297,696
<u>203,726</u> *	<b>Total</b>	<u>113,044</u>	<u>316,770</u>

\* As in original Estimate (HC 284-V of 1985-86) plus Supplementary Estimate (HC 439 of 1985-86 and HC 8 of 1986-87).

## Subhead Detail

Present provision		Increase/ excess	Decrease/ shortfall	New provision
£'000		£'000	£'000	£'000
	<b>Section A: Support for aerospace, shipbuilding, steel and vehicle manufacture</b>			
23,030	<b>A1 Grants to British Shipbuilders for redundancy payments</b> Payments under the Shipbuilding, Redundancy Payment Scheme to assist eligible employers of British Shipbuilders affected by redundancy and restructuring and to meet related administrative costs The decrease is because British Shipbuilders have provided a much firmer (and lower) forecast of the number of redundancies to be paid before the scheme ends	—	3,956	19,074
	<b>Section B: Nationalised industries external finance</b>			
160,000	<b>B1 Provisions of public dividend capital to British Shipbuilders</b> The Government announced in October 1979 that British Shipbuilders would not pay dividends on its PIDC until the corporation was profitable. Article 93 of the Treaty of Rome allows the European Commission to investigate the provision of aid Additional public dividend capital (PIDC) provision is sought for British Shipbuilders to meet financing needs resulting from the additional costs this year of customer defaults and the effects of delays in securing new orders	123,000 <del>120,000</del>	—	280,000
22,000	<b>B2 Assistance under sections 7 and 8 of the Industrial Development Act 1982</b> Grants from the shipbuilding Intervention fund to enable UK public sector yards to compete with non-EC countries on merchant shipbuilding orders Demand lower than originally predicted	—	6,000 <del>3,000</del>	16,000 <del>19,000</del>
	<b>Total</b>	<u>117,000</u>		

Part III

**EXTRA RECEIPTS PAYABLE TO THE CONSOLIDATED FUND**

No extra receipts are expected



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Treasury Chambers, Parliament Street, SW1P 3AG

Giles Shaw Esq MP  
Minister of State for Industry  
Department of Trade and Industry  
1 - 19 Victoria Street  
London  
SW1H 0ET

10 December 1986

*Dear Minister,*

**FINANCIAL POSITION OF BRITISH SHIPBUILDERS**

Thank you for your letters of 21 November and 8 December concerning the breach of British Shipbuilders' (BS) current EFL of £130 million.

This is extremely disappointing news to say the least and it raises again the question of the cost in public expenditure terms of supporting what is, after all, a relatively small industry. When we took decisions in E(A) in July on BS' Corporate Plan, we decided to look again at the future of the business in the autumn in the light of developments on the various orders which were then being negotiated. Since BS' financial position has deteriorated so greatly recently, I would like to suggest that we fix a firm date for collective consideration of the future of the business some time early in the New Year, irrespective of the fate of any particular orders. I hope that you can agree to this.

In the meantime, I hope that you will urge BS to consider as quickly as possible the most cost-effective option for the future of the ITM Challenger and the scope for possible savings. Given that the future of some yards, especially Govan and Greenock, is so uncertain, I think there is a good case for delaying capital expenditure wherever possible. When we are clearer on the costs of the ITM Challenger and the scope for savings, we will need to agree a new EFL for BS as quickly as possible. Until then, I am sure that you will impress on Mr Hares the need for BS to at least stay within the limit of £155 million on the external financing needs of the continuing business which you announced in the House on Monday night.

*Yours sincerely,*

*John MacGregor*

PP JOHN MacGREGOR



DEPARTMENT OF TRADE AND INDUSTRY  
1-19 VICTORIA STREET  
LONDON SW1H 0ET

Telephone (Direct dialling) 01-215  
GTN 215) .....5186  
(Switchboard) 01-215 7877

From the Minister of State for Industry

GILES SHAW MP

The Rt Hon John MacGregor  
Chief Secretary  
H M Treasury  
London

CHIEF SECRETARY	
MR	7 DEC 1986
TO	Mr Colman
	CX FST Sir Peter Middleton
	Mr Butler Mr Mack
	Mr Bugner Mr Gilmore
	Mr Moore Mr Scholier

19 December 1986

Mr Turnbull Mr Cropper  
Mr C.A. Jones Mr Tyrie

*Dear John*

FINANCIAL POSITION OF BRITISH SHIPBUILDERS

Thank you for your letter of 10 December. I agree that you and I need to keep the very disappointing state of affairs at British Shipbuilders under close review. Paul Channon has just minuted the Prime Minister about the uncertainties at Govan and said tht he intends to report further to colleagues after the BS Board meeting at the end of January. I know he would be content for there to be a meeting of colleagues thereafter, though in view of the sensitivity of the matter, it might well be appropriate for that meeting to be confined to those with a direct interest. You will see the relevance of the Board meeting from Paul's minute.

On financial control I have written to Phillip Hares setting out in no uncertain terms the importance we attach to his observing the £155m limit. I also made clear our reaction to the breach of £130m EFL.

I discussed the ITM Challenger with Phillip Hares when I met him on 1 December and again today and stressed that the Corporation should identify as soon as was feasible the most cost effective option for dealing with the ship. Mr Hares anticipated that he would be able to give me a clear view early in January. I shall write again when that is to hand. I have reminded him of this in my letter today. However, the timing of the new External Finance Limit will also be determined by the circumstances at Jebsens of Bergen to which I referred in my letter of 8 December. The timing of the financial reconstruction is harder to forecast but yet again I have asked Mr Hares to give us clear advice as soon as he can.

TUEBOY



You write about delaying capital expenditure wherever possible. I am advised that almost all the £9.6m forecast for 1986/87 is now subject to contract and I would prefer to leave any rephrasing to the Corporation within the discipline of the £155m limit since that was part of the basis on which my officials agreed the limit with the Corporation. However, my officials have made clear to British Shipbuilders that they do not necessarily accept all that the additional capital investment of £9m identified for 1987/88 will be essential bearing in mind the uncertainty about some of the Corporation's orders and the consequences for Govan and Clark Kincaid at Greenock. I have asked them to discuss the position with BS in the light of the Corporation's January Board and any subsequent decisions.

A handwritten signature in dark ink, appearing to read 'Giles Shaw', written in a cursive style.

GILES SHAW



b/f with  
advise p1

10 DOWNING STREET

From the Private Secretary

29 January 1987

Dear Tom,

I attach a copy of a letter the Prime Minister has received from Mr.W.G. Runciman, President of the General Council of British Shipping.

I should be grateful if you could provide a draft reply for the Prime Minister's signature, to reach me by Thursday 12 February.

I am copying this letter to Sarah Straight (Department of Transport).

CH/EXCHEQUER	
REC.	29 JAN 1987
ACTION	FST
COPIES TO	

Yours,

David.

(DAVID NORGROVE)

Tony Kuczys, Esq.,  
HM Treasury.

PRESIDENT:

THE HON. W.G. RUNCIMAN

Telephone 01-283 2922

GENERAL COUNCIL OF BRITISH SHIPPING

30-32 ST. MARY AXE

LONDON, EC3A 8ET

27th January, 1987

The Rt. Hon. Margaret Thatcher, MP.,  
The Prime Minister,  
10, Downing Street,  
London, SW1A 2AA.

R29

PPS

Dear Prime Minister,

Thank you for your letter of 12th January about accelerated capital allowances for ships. I am grateful to you for replying so fully, but I feel bound to say that I am seriously disturbed by the weakness of the case for continuing inaction which you have set out.

You assure me, and I entirely accept, that both defence and civil resupply needs are kept under constant review. But if your information is fully up-to-date, I find it hard to see that you need the evidence of a further study which, by the time its results are available to you, will leave the charge of complacency difficult to rebut. If nothing is done, it can only be a very short time indeed before the continuing transfer of existing ships to more cost-competitive and progressively more distant registries and the channelling of new investment (whether in new or secondhand ships) outside the UK leaves the country without a Merchant Navy adequate for its strategic needs. When that time comes, it will be too late to take remedial action by fiscal means; and the dismantling of protectionism, welcome and valuable as it is, makes no difference to the serious competitive disadvantage at which British shipowners are placed on capital costs. These are essentially under Government control; and, as you know, the other member states of the European Community offer significantly more assistance for investment in ships than Britain does.

You are, of course, right in saying that front-loaded allowances, like cash subsidies, distort the free operation of the market. British shipowners would be only too pleased if the governments of other maritime countries shared your Administration's views and there were no need to have recourse to either. But if one or the other has to be done, I do not see how it can be denied that cash subsidies are much less efficient, much more costly, and much more distorting of the free operation of the market than capital allowances are. Your Administration intervenes elsewhere in the market on pragmatic grounds, not only with Regional Development Grants but also in the Business Expansion Scheme. Does not the strategic need for an adequate merchant fleet constitute a sufficient reason for cost-effective intervention by fiscal means?

Likewise, it is not in dispute that investment incentives have resulted in the past in the building of a good many ships - principally tankers in the period up to the oil crisis of 1974 - which had subsequently to be sold as unprofitable. But that does not alter the fact that without restoration of something approaching equivalence to the allowances on which British shipowners could draw up to 1984, few of them, in the conditions of the late 1980's, will have any practical choice but to place their new investment outside the UK. As late as 1983, while older ships were being sold, British owners still placed orders totalling 360,000 dwt for UK registry. In 1985, the first year of the new regime, the figure was 27,000 dwt. In the first nine months of 1986 it was 5,000 dwt.

Allow me to repeat, if I may, that we are not seeking commercial favours. If our shareholders' interests are better served by our owning, registering and manning our ships abroad, we shall have to do so (as many of us already are). But the consequences for the nation will be squarely and solely the responsibility of Government.

If it would be of any help to discuss these issues face to face, I am, of course, at your disposal.

Yours sincerely,

W.D. Brown



DEPARTMENT OF TRADE AND INDUSTRY  
1-19 VICTORIA STREET  
LONDON SW1H 0ET

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(Switchboard) 01-215 7877

From the Minister of State for Industry

GILES SHAW MP

The Hon Archie Hamilton MP  
PUSS (Defence Procurement)  
Ministry of Defence  
Main Building  
London  
SW1

CHIEF SECRETARY	
REC.	- 4 FEB 1987
ACTION:	Mr Coleman
COPIES TO:	CXFST Sir Peter Middleton
	Mr Butler Mr Monea
	Mr Banger Mr Moore
	Mr Gilmore Mr Robson Mr Schister

Mr Gilmore

Mr Turnbull Mr Cropper  
Mr Tyrie.

3 February 1987

*Dear Archie*

We both met Directors of Vosper Shiprepairers last Thursday. It seems certain that this small company employing approximately 200 people in Southampton will go out of business this week. It should not, of course, be confused with Vosper Thornycroft Ltd, the Southampton-based warshipbuilder which is no way involved.

I understand that Vosper Shiprepairers have made a competitive bid for the MOD contract, worth over £1.5m, to refit the Sir Geraint. However they cannot provide the performance bond MOD require nor have they the working capital to finance the contract. Since privatisation in 1985, the company has been dependent on a loan facility of £1.65 million (excluding interest) for working capital from British Shipbuilders. This loan is more than adequately secured but BS consider it would not be prudent for it to increase the loan sufficiently for the company to meet MOD's contractual conditions. I do not believe it would be right to press BS to increase its exposure against its commercial judgement. I understand that you are not prepared to relax the contractual conditions not least because the next best bid is from Smiths Shiprepairers, a Tyneside yard. It therefore seems inevitable that the company will have to call in an Administrator next week.

Vosper Shiprepairers' failure could cause us some embarrassment as the company was privatised by British Shipbuilders selling to the management a little over a year ago. To add to the embarrassment, the main reason why they cannot meet MOD's conditions is a dispute



between themselves and the National Environment Research Council, a public sector body, over a recently completed contract. I understand that NERC has now agreed to this being settled by an independent arbitrator. However whatever the outcome, this is certain to take too long to save the company.

I am copying this letter for information to the Prime Minister, the Secretaries of State for Defence and for Education & Science, the Chancellor of the Duchy of Lancaster and the Chief Secretary.

*Giles Shaw*

GILES SHAW



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FROM: J G COLMAN  
3 February 1987

CHIEF SECRETARY

cc PPS  
FST  
MST  
EST  
Sir P Middleton  
Mr F E R Butler  
Mr Monck  
Mr D J L Moore  
Mr Mountfield  
Miss Peirson  
Mrs M E Brown  
Mr Hood

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workforce?*

BRITISH SHIPBUILDERS

This is a further brief report on where matters stand with BS. No decisions are called for yet. Mr Channon is likely to write to colleagues next week.

2. The most pressing problem is the future of Govan. Although DTI have not entirely given up hope that pressure on the French Government from Brussels might lead to the award of the Brittany Ferries contract, the only real prospects of order are China and St Helena.

3. A new problem has emerged with China: the Chinese now want bigger ships than they had previously been seeking, but they don't want to pay any more for them. To build 3 ships would now cost BS much more than the £66m already agreed. Two could be built within the original budget, but BS fear the Chinese might refuse to discuss as few as two (they were talked down from 5 to 3 only with difficulty).

4. The St Helena order, if won by BS, would be welcome, but it is not much in itself (about one-fifth of the size of Govan's current ship, the Norsesea Ferry). If Govan were building 3 ships for China, there would be no capacity at Govan for the St Helena ship.

5. BS's only other big yard, North Eastern Shipbuilders Limited (NESL) is in trouble of a different kind. Cost overruns on their existing workload suggest that the management of NESL needs to

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be shaken up. BS have that in hand, but NESL is clearly a much less well managed yard than Govan. NESL also has an extremely bloody-minded workforce (half of whom went on strike for a six weeks ending in mid-January).

6. Options being considered by DTI include:

- a. Closing Govan;
- b. 2 Chinese ships for Govan;
- c. 3 Chinese ships for Govan;
- d. closing NESL and cancelling their current Danish ferry order;
- e. closing NESL and transferring the Danish order to Govan.

7. No proper costings have yet been produced for these options: DTI are at work on this. Some of them may not be feasible simply because DTI and BS are not fully in control of their circumstances (eg the 2 ships for China may be unacceptable to the Chinese). All the options are likely to involve increases in BS's external finance requirement over the next year or two: even if BS win more orders, they now expect to have to subsidise them to a greater extent than foreseen in their Corporate Plan; and if they do not win orders, closures involve extra costs in the short term.

8. As decisions may need to be made quite quickly after next week, we will keep you in touch with developments. It will be particularly important to have realistic rather than optimistic assessments of the costs of the various options, a point which DTI officials have very much in mind.

J.G.C.

J G COLMAN

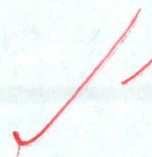
PUP



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CH/EXCHEQUER	
REC.	06 FEB 1987 T6/2
ACTION	CST
COPIES TO	

PRIME MINISTER



BRITISH SHIPBUILDERS.

This minute brings you up-to-date with the serious position at British Shipbuilders (BS) and proposes a course of action.

2 The position has worsened since my minutes to you of 17 December and 22 January. There are continuing delays in obtaining orders at Govan and the performance at North East Shipbuilders Limited (NESL) is deteriorating, in part because of the effects of the recent strike. As a result, although BS still expect to remain within the firm limit of £155m for this financial year agreed with the Chief Secretary for their ordinary activities, it now seems unlikely that they will be able to stay within the EFLs set for 1987/88 and indicated for 1988/89. Without further action by BS they may need about £139m over the two years together rather than the target of £104m.

3 I have told Phillip Hares that he must operate within the Contract Support Limits already set and planned for the next three years, and have asked for early advice from his board on the action needed to restore BS to the financial path set last Autumn. Further action is needed to rectify the position at NESL and Hares has decided this week on major management changes, to be announced on 10 February. I have also encouraged him to get the Board to consider whether

JF 4AOG



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further rationalisation, slimming down, or closure of facilities is necessary to achieve this result. Whatever the short term costs of any further rationalisation I have asked him to come forward with with plans that keep the cost of the continuing business below the EFLs set or indicated for the next three financial years. We will need in the light of that information to decide what course to follow taking account of the broader consequences of our action.

4 As I indicated in my minute of 17 December, if the Brittany Ferry is lost - as is increasingly likely - and the China orders remain uncertain, the BS Board are likely to recommend closure of Govan. Clearly, on commercial and economic grounds, this is the correct course; the cost of keeping Govan open without work is between £1.5 and £2m a month and its long term future is very bleak. However the delays on the orders are not of Govan's making, and the timing of the closure would cause considerable difficulties. I have therefore looked for ways of keeping Govan open.

5 The key is the China contract. The Chinese have asked BS to begin negotiations in Hong Kong for a three ship contract on Monday. BS expect to be able to deal with technical matters first, but will inevitably move on to commercial aspects within a few days. We must therefore decide quickly on the financial arrangements. Recent changes in the Chinese specification have increased the cost requiring a further £6m of soft credit to be made available beyond the £66m agreed last Summer. This level of credit support costs £24m. In addition a direct subsidy to BS of between £25m and £30m would be required, depending on the precise specification of the ships. BS can accommodate this within existing Contract Support Limits referred to in para 3.



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6 I have considered carefully what other alternatives short of closure are available. To attempt to reduce the order to two ships (and hence reduce the cost to the Government) carries the very real danger that the Chinese would refuse to negotiate, with the deal either being lost or delayed for some months. During that period Govan could be without even the prospect of work unless they were successful in winning the relatively small ship for St Helena. Even if they win the order from China quickly, the yard would be empty for several months.

7 I have also considered whether we could ask BS to negotiate with the Chinese but avoid becoming committed to a deal until we have the extra information from BS on costs in some weeks' time. This is theoretically possible, but there would be a clear risk that the Chinese would take umbrage at BS's delaying tactics and BS could lose the contract as a result.

8 Given the difficulties, I believe we should agree that BS can negotiate with the Chinese for three ships on the basis of paragraph 5 and secure a contract if they can. This means increasing by £6 m the amount of soft credit available to BS. (I attach a short Annex explaining how this would relate to the other projects covered by the Chinese soft loan facility). If, however, they are unable to reach early agreement with the Chinese, the position at Govan will be all the more difficult, but we will be able to review the position again in fuller knowledge of the alternatives open to us.



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9 I propose therefore, subject to the views of colleagues, to authorize BS to negotiate with the Chinese for the purchase of three ships. I will keep you fully informed.

10 I am copying this minute to the Chancellor of the Exchequer, the Foreign Secretary, the Chancellor of the Duchy of Lancaster, the Secretary of State for Scotland, the Secretary of State for Employment, and the Secretary to the Cabinet.

P.C.

PAUL CHANNON

6 February 1987

DEPARTMENT OF TRADE AND INDUSTRY

JF4AOG



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NOTE ON SOFT CREDIT

The Chinese Authorities regard £50m of the £300m soft loan facility agreed last year, as provisionally allocated to container ships. When 3 smaller ships were being considered for support, the Chinese were assured that the additional £16m likely to be involved would, if necessary, be found outside the £300m. We were careful however to present this as an exceptional measure and to guard against its being interpreted as an indication of any more general willingness to go beyond the £300m ceiling.

Although the further increase now proposed is relatively small, it nevertheless faces HMG with similar presentational problems. On the other hand, the position is helped by the increase being within what we understand is the 10 percent limit of discretion in Chinese planning. If the Government does go down this route, it will have to indicate to the Chinese that it is prepared to accommodate the extra £6m on top of the previously discussed £66m, without prejudice to the other soft loan projects. There is, of course, still substantial uncertainty over the contract prices for the remaining four projects, on the assumption that they go ahead as planned.

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*PWP B*  
*BIF*  
*13/2*  
*10/7*  
*16/2*



FROM: CATHY RYDING  
DATE: 6 February 1987

PS/CHIEF SECRETARY

*Refind out when  
we will get  
answer to X*

cc: FST  
MST  
EST  
Sir P Middleton  
Mr F E R Butler  
Mr Monck  
Mr D J L Moore  
Mr Mountfield  
Miss Peirson  
Mrs M E Brown  
Mr Colman  
Mr Hood

**BRITISH SHIPBUILDERS**

The Chancellor has seen Mr Colman's minute to the Chief Secretary of 3 February.

2. The Chancellor thinks that option 6 (e) looks well worth exploring. He would be grateful to know the size of the NESL workforce.

*CR*

CATHY RYDING



*Ref*



FROM: S I M KOSKY

DATE: 6 February 1987

MR COLMAN

cc:

- Principal Private Secretary
- Financial Secretary
- Minister of State
- Economic Secretary
- Sir Peter Middleton
- Mr F E R Butler
- Mr Monck
- Mr D Moore
- Mr Mountfield
- Miss Peirson
- Mrs M E Brown
- Mr Hood

BRITISH SHIPBUILDERS

The Chief Secretary agrees with the points made in paragraph 8 of your submission of 3 February.

A handwritten signature in cursive script that reads "Sheldon Kosky". The signature is written in dark ink and has a long, sweeping underline.

S I M KOSKY

CONFIDENTIAL

FROM: J G COLMAN  
9 February 1987

CHIEF SECRETARY

cc

✓ PPS

Mr F E R Butler  
Mr Monck  
Mr D J L Moore  
Mr Mountfield  
Miss Peirson  
Mr Turnbull  
Mrs M E Brown  
Mr Hood

## BRITISH SHIPBUILDERS

Mr Channon's minute of 6 February to the Prime Minister reports the worsening in BS's position which I reported in my submission of 3 February.

2. Rather unexpectedly Mr Channon seeks immediate agreement to the proposal that BS should be authorised to continue to negotiate with the Chinese for the supply of 3 ships, despite the higher costs to BS that will involve. A decision is needed very quickly because the Chinese have just summoned BS to negotiate as from today and have told them to be ready to sign a deal (previous negotiations have been at a more technical level). BS will probably need to know whether they can negotiate on the above basis by the end of the week, but clearly the sooner a decision can be taken the less likely it is to put them into a false negotiating position.

3. As foreseen in my 3 February submission, Chinese experts have confirmed BS's judgement that to offer only 2 ships would be quite unacceptable to the Chinese who would immediately turn to the Germans who have been waiting in the wings all along.

4. BS' current estimate of the financial implications of their winning all the orders they might hope to is that external finance requirements will increase by £35 million in 1987-88 and 1988-89 over the IFR outcome. Only a small portion of this relates to the extra costs of the China ships. If they are not permitted to go for 3 China ships, Govan will have no work and would either have to be closed with an immediate cost of £25-30m in redundancies (but savings later), or kept open at a cost of some £12-18 million a year.

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5. On ATP, our original agreement with the Chinese was for a soft loan facility of £300 million to cover a number of projects. We have already had to agree that up to £16 million extra will be available as necessary to finance the 3 ships. It is unfortunate that we are now being asked to increase the total yet again. It risks giving the Chinese the impression that they need not take the control totals seriously. It would however be unrealistic to suggest that the £6 million be accommodated within the existing China facility, which it is already earmarked for other projects.

6. There is, however, room within the overall ATP allocations. If we agree the £6 million, it must be on the understanding that it is met from within that existing provision. It will be important too that it can be presented to the Chinese without raising undue expectations for any further increases either for the ships or for any other projects.

Assessment

7. Mr Channon's proposal is not unexpected, but the speed with which he is seeking a decision is. As we have consistently pointed out, by any normal criteria much or all of BS should have been closed down at the first opportunity. Profitable merchant shipbuilding work cannot be found: the only purpose in taking orders is to keep the yards open.

8. In our view the only choices open to the Treasury are either to agree at once to Mr Channon's proposal but on condition that there is a collective discussion of BS's future at the earliest opportunity, or, alternatively, to withhold agreement until Ministers collectively have discussed Mr Channon's minute.

9. Given the relatively small financial implications of the specific proposal on China, we recommend the former. I attach a draft letter to Mr Channon.

J. G. C.

J G COLMAN

Enc

DRAFT letter from the CHIEF SECRETARY

to the SECRETARY OF STATE FOR TRADE & INDUSTRY

**BRITISH SHIPBUILDERS**

Your minute of 6 February to the Prime Minister paints a very sombre picture. The cost of supporting British Shipbuilders, which is now quite a small industry in employment terms, seems to have taken on a virtually irresistible upward momentum. On the other hand, I recognise the difficulties which the alternative to your proposal - likely closure of one or more of the yards - would bring. I am therefore prepared to accept that you should authorise BS to negotiate for three ships for the Chinese along the lines of your paragraph 5, but only on condition that we have a collective discussion of BS's future at the earliest opportunity.

It will be important in BS's negotiations that the additional £6 million ATP is not presented to the Chinese in such a way as to give rise to expectations of further flexibility either for the ships or for other projects.

I am copying this letter to the recipients of yours.



SCOTTISH OFFICE  
WHITEHALL, LONDON SW1A 2AU

*put*

CONFIDENTIAL

The Rt Hon Paul Channon MP  
Secretary of State for Trade  
and Industry  
1 Victoria Street  
LONDON  
SW1H 0ET

CH/EXCHEQUER	
REC.	09 FEB 1987 ✓ 9/12
ACTION	CST
COPIES TO	

9 February 1987

Dear Secretary of State

BRITISH SHIPBUILDERS

Thank you for copying to me your minute of 6 February to the Prime Minister.

In the circumstances you describe there can be no question but to authorise the increase in soft credit available to British Shipbuilders to negotiate the Chinese order. You have my strongest support.

There is no need to repeat again my concern about Govan. While I note the increasing difficult financial position British Shipbuilders may face, we would have, as you undertake in your minute, to review the position with the upmost sensitivity before even contemplating such a damaging course as closure.

I have written separately today about the St Helena order.

I am copying this letter to the Prime Minister, Chancellor of the Exchequer, Secretaries of State at FCO and Employment, Chancellor of the Duchy of Lancaster and to Sir Robert Armstrong.

*Yours sincerely  
Andy Rinkind*

*H*

MALCOLM RIFKIND

Approved by  
the Secretary of State  
and signed in his absence.



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CH/EXCHEQUER	
REC.	10 FEB 1987 10/2
ACTION	CST
COPIES TO	

PM/87/008

PRIME MINISTER

British Shipbuilders

1. Paul Channon has proposed in his minute to you of 6 February that the soft loan support available for three container ships for China, at present being negotiated by British Shipbuilders, should be increased from £66 million to £72 million.
2. This is clearly a very important order for British Shipbuilders and I support his proposal. I accept that we shall therefore need to make available an additional £22 million, rather than the £16 million earlier agreed, on top of the original £300 million soft loan facility.
3. However, I should like to recall the point I made in my minute of 1 August to Paul Channon. The purpose of the soft loan facility is to stimulate business on normal commercial terms. We must avoid giving the Chinese the impression that we have a bottomless purse with which to support contracts with concessional finance.
4. I am copying this minute to Nigel Lawson, Paul Channon, Norman Tebbit, Malcolm Rifkind, David Young, and Robert Armstrong.

(GEOFFREY HOWE)

*RWF*

Caxton House Tothill Street London SW1H 9NF

Telephone Direct Line 01-213.....6460  
 Switchboard 01-213 3000 GTN Code 213  
 Facsimile 01-213 5465 Telex 915564

The Rt Hon Paul Channon MP  
 Secretary of State for Trade and Industry  
 1 Victoria Street  
 LONDON  
 SW1

11 February 1987

*Paul***BRITISH SHIPBUILDERS**

You wrote to the Prime Minister on 6 February about the Chinese ship orders. I agree that there seems to be no alternative to extending the soft loan facility by an extra £6 million if British Shipbuilders is to have any chance of winning the Chinese order. We should if possible leave open the source of the extra £6 million so that it is included within the total £300 million soft loan package with China if at all possible.

I believe it is important to consider the impact of the Chinese ship orders in the context of the other orders which British Shipbuilders has been seeking to win, and I hope that the plans you have asked the BS board to produce will help us to look again at the likely future for shipbuilding.

I am copying this to the Prime Minister, Nigel Lawson, Geoffrey Howe, Norman Tebbit, Malcolm Rifkind and Robert Armstrong.

*Lawson*

CH/EXCHEQUER	
REC.	11 FEB 1987
ACTION	CST
COPIES TO	

CH/EXCHEQUER	
REC.	13 FEB 1987 13/2
SECTION	CST
COPIES TO	

CONFIDENTIAL



10 DOWNING STREET  
LONDON SW1A 2AA

12 February 1987

From the Private Secretary

Dear Michael,

BRITISH SHIPBUILDERS

The Prime Minister has seen your Secretary of State's minute of 6 February which in particular discussed the position at Govan and the possible China contract.

The Prime Minister is content that the soft loan facility should be increased by £6 million. However, with the Chief Secretary and the Foreign Secretary, she would hope that this can be offered in a way which would not lead the Chinese to hope or expect a further improvement.

The Prime Minister also agrees with the Chief Secretary that it would be useful to hold an early collective discussion of the position of British Shipbuilders. She believes it would be useful to consider the position of shipbuilding generally at the same time, and has asked that the Ministry of Defence should also prepare a paper on the warship yards in the light of the latest prospects for warship ordering. The intention would be to hold a meeting of E(A) to discuss the papers on British Shipbuilders and on the warship yards in early March.

I am copying this letter to Alex Allan (H.M. Treasury), Tony Galsworthy (Foreign and Commonwealth Office), Andrew Lansley (Chancellor of the Duchy of Lancaster's Office), Robert Gordon (Scottish Office), John Turner (Department of Employment) and Trevor Woolley (Cabinet Office).

Yours,  
David

DAVID NORGROVE

Michael Gilbertson, Esq.,  
Department of Trade and Industry.

CONFIDENTIAL





DEPARTMENT OF TRADE AND INDUSTRY  
1-19 VICTORIA STREET  
LONDON SW1H 0ET

Telephone (Direct dialling) 01-215

GTN 215 5186

(Switchboard) 01-215 7877

From the Minister of State for Industry

GILES SHAW MP

Rt Hon John McGregor  
Chief Secretary  
H M Treasury  
Parliament Street  
London

CHIEF SECRETARY	
REC.	13 FEB 1987
ACTION	Mr Colman
COPIES TO	CX FST Sir Peter Muddles Mr Butler Mr Anson Mr Monck Mr Burgess Mr Moore Mr Scholast Mr Robson
MP	

Mr Turnbull Mr Boote

13 February 1987

Mr Cropper Mr Tyrie

Dear Chief Secretary,

BRITISH SHIPBUILDERS EXTERNAL FINANCE LIMIT

I understand that in advance of the publication of the Spring Supplementaries on Tuesday 17 February we should agree and announce a new EFL for British Shipbuilders.

I propose I should announce a limit of £244m in terms of the draft Answer attached to this letter. The sum consists of £155m for the continuing businesses within BS control, the firm limit I announced on 8 December; £11m for the financial reconstruction of Jebsens of Bergen; £32m for settlement with Scott Lithgow; £41m in respect of the default of ITM Offshore on the Challenger contract; and £5m in respect of Arctic Offshore Limited.

When I wrote to you on 8 December about the £155m limit, the explicit assumption was that the Arctic Explorer would be sold to Arctic Offshore Limited for £5m this year. The company is now in deep enough trouble again for BS to be satisfied the sale will not take place this year. I am sure you will agree this is a matter completely beyond the Corporation's control. Nevertheless, I am separately making clear my concern to British Shipbuilders that the flexibility forecast in December that would have allowed the £5m to fall within a cash deficit of £155m has been absorbed by other developments.



Of these, £6m represent delayed payments solely as a result of shortcomings at North East Shipbuilders, where radical management action has just been taken. The previous Managing Director has relinquished his position; the Board member for Production has become Executive Chairman, and the Main Board Members for Finance and Personnel and Industrial Relations have joined the NSEL Board. I am satisfied the new team will do everything possible to recover the position at the yard.

On the other hand, a further £2½m has been delayed principally because the Export Credits Guarantee Department working with Danish lawyers are unlikely to be able to complete their contributions to the financial documentation for the Danish ferry order by the end of this year. And I note British Shipbuilders have cut their proposed capital expenditure by £3m and are prepared to inconvenience their creditors to the maximum extent with the aim of living within the limit we have set.

On Jebsens, whereas BS had earlier expected £18m of cash would be needed for reconstruction this financial year, they now expect £11m to be needed before the end of March and £7m thereafter. I understand your officials therefore prefer provision for £11m to be made within the EFL giving an overall figure very close to the provision of £246m public dividend capital proposed by the Spring Supplementary. I am advised that the timing of these payments is completely beyond their control since Japanese bankers have the primary role in the financial reconstruction of Jebsens. I shall therefore regard it as no fault of British Shipbuilders if the full £18m is required within the financial year.

In the draft Answer I have only referred to the £41m in respect of the receivership of ITM. Commercial considerations argue against the provision of information on the other components at this stage.

*Yours sincerely,*  
*Giles Shaw*

GILES SHAW

Approved by the Minister and signed in his absence.

**PARLIAMENTARY QUESTION**

For answer on:.....  
(DAY) (DATE)

If ORAL  
insert X

If for  
WRITTEN  
ANSWER  
leave blank

If for  
PRIORITY  
WRITTEN  
insert W  
and give  
date for  
answer

Name.....

Constituency (.....):

To ask..... The Secretary of State for Trade and Industry

.....  
(TITLE OF MINISTER)

If he will make a statement on the external financing  
limit for British Shipbuilders for 1986-87.

Signed.....

DRAFT PARLIAMENTARY ANSWER

In the Debate on the British Shipbuilders (Borrowing Powers) Bill on 8 December, I announced that British Shipbuilders external finance limit for 1986/87 would be revised formally once we were clearer about how some of the major uncertainties arising from the Corporation's clients were to be resolved. In the meantime, I announced a firm limit of £155m on the financing needs of the continuing businesses in areas the Corporation could control.

The position on the major uncertainties is now such as to allow a new EFL of £244m to be set. Of the increased part of this sum, the largest element is a cash requirement of £41m in 1986/87 as a direct result of the Receivership of International Transport Management Limited. As I told the House on 8 December, BS has advised that it expects to be able to recover some of these costs in due course.

Provision for this additional funding in the form of public dividend capital is subject to Parliamentary approval of the necessary Supplementary Estimate. The increase in the EFL will be charged to the Reserve net of some offsetting savings on existing programmes. Therefore there is no increase in the public expenditure planning total.

CONFIDENTIAL

Pages  
Pge.FROM: W HOOD  
16 February 1987

CHIEF SECRETARY

cc Chancellor  
FST  
Sir P Middleton  
Mr F E R Butler  
Mr Anson  
Mr Monck  
Mr Burgner  
Mr Moore  
Mr Robson  
Mr Scholar  
Mr Turnbull  
Mrs Brown  
Mr Colman OR  
Mr Parkinson  
Mr C A Jones  
  
Mr Cropper  
Mr Tyrie

## BRITISH SHIPBUILDERS: 1986-87 EFL

Giles Shaw's letter of 13 February seeks your agreement to a revised EFL for British Shipbuilders of £244 million, an increase of £114 million over the existing EFL. I recommend that you agree to this change.

2. The issues involved in the deterioration of BS's financial position this year have been fully discussed in Mr Jones' submission of 9 December and Mr Colman's submission of 18 December. The delay in setting the EFL has been due to the uncertainty surrounding the timing and amounts of certain large payments and receipts by BS, which are largely beyond their control. The EFL effects of these items are in addition to the £155 million limit which Mr Shaw announced in the House on 8 December for the "continuing business" - already an increase of £25 million over the existing EFL. The uncertainties surrounding these items have now reduced sufficiently for an EFL to be set.

3. The current position on each of the major items is as follows:

- (1) it is virtually certain that BS will not receive any income this year in respect of the ITM Challenger, a craneship which BS were building for ITM, now in receivership. The cost of this in EFL terms is

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£41 million this year, but perhaps half of this may be retrievable in 1987-88 on the basis of a sale to a third party;

(ii) Trafalgar House are now keen to settle their dispute with BS over Scott Lithgow before 31 March. BS estimate that they are liable to pay up to £32 million under the arbitrator's judgment but there are some minor areas of flexibility and they may be able to negotiate a slightly lower sum. Given that the margin of uncertainty is small, it now seems sensible to include the likely cost of the Scott Lithgow settlement in the formal EFL;

(iii) BS now expect £11 million rather than the full £18 million to be required for the reconstruction of Jebbens this year, with the remaining £7 million needed next year. The actual timing of any cash payments required is not within the control of BS, so that including the full £18 million in the EFL would not encourage the payment of the additional £7 million this year rather than next. To set an EFL which took account of the full £18 million could be criticised on the grounds that it would be setting a control which was too loose, given that the best estimate is that only £11 million will be required. It might encourage BS to be less careful in areas of expenditure over which they do have some control, and which cannot be recovered in later years. In the circumstances, it seems most sensible to include only the £11 million in the EFL.

4. A further £5 million, not included in earlier assessments, is now required because it is clear that BS will not be able to sell the Arctic Explorer this year due to financial difficulties with the owners, Arctic Offshore Limited. It is not clear at this stage whether BS will ultimately be able to sell the ship at the original contract price to Arctic Offshore, or if they will be forced to make a distress sale at a much lower price.

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5. The revised EFL is made up as follows:

	<u>£m</u>
Existing EFL	130
Additional provision as announced on 8 Dec	25
ITM	41
Scott Lithgow	32
Jebsens	11
Arctic Offshore	5
Recommended revised EFL	244

6. GEP's latest assessment of the Reserve assumes an EFL of £246 million. The EFL now being recommended is £2 million less than this (-£7 million due to the changed assessment relating to Jebsens and +£5 million due to Arctic Offshore). The Spring Supplementary on Class V, Vote 4 is also consistent with an EFL of about this amount - the EFL and Supplementary are not precisely tied, because temporary borrowing by BS is included in the EFL but not of course in the Supplementary.

7. Some of the factors leading to an increased external financing requirement this year also involve the possibility of receipts in 1987-88 which were not expected when the IFR was completed. The most notable of these is the ITM ship, which BS estimate can be sold when completed for at least £20 million. There are also some instalment payments on other ships which have slipped into next year. Against this, there are some instalment payments on the ITM ship previously expected in 1987-88 but which will not now be received at all; and the £7 million Jebsen's payment now expected next year was not known about when the 1987-88 EFL was set. We think that the net effect of the above factors is to reduce next year's EFL and it is worth flagging the point now in your letter to Mr Shaw to ensure that they are taken into account in any reassessment of the 1987-88 EFL.

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Offsetting savings

8. The only offset is £3.956 million for reduced Shipbuilding Redundancy Payment Scheme expenditure, incorporated in the spring Supplementary. In principle, this is not sufficient, but as you know we have been pressing DTI for offsets against other claims, in particular RDG. So there is no realistic scope for further savings. But this reinforces the need to obtain an EFL improvement next year.

9. I recommend that you should agree a revised EFL for BS of £244 million. GEP2 agree.

10. I attach a draft letter for you to send to Mr Shaw. If you are content, we will clear the PQ at official level.

Warwick Hood

W HOOD

Enc



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DRAFT LETTER to:

Giles Shaw Esq  
Minister of State for Industry  
Department of Trade and Industry  
1 Victoria Street  
LONDON SW1H 0ET

**BRITISH SHIPBUILDERS : EXTERNAL FINANCE LIMIT**

I am content for you to announce a revised 1986-87 EFL of £244 million for British Shipbuilders as proposed in your letter of 12 February, and I agree the associated £114 million claim on the Reserve.

While I recognise that much of this very large increase in external finance represents claims which are irretrievable and cannot be offset elsewhere, I note that some of the factors behind the increase this year also involve previously unexpected receipts of income in 1987-88. I attach particular importance to making clear that the implications of these receipts for British Shipbuilders are incorporated in the 1987-88 EFL in due course.

I am content for my officials to clear the terms of the PQ with yours.

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Cx FST  
 Sir P. Middleton  
 Mr F. Butler  
 Mr Anson  
 Mr Monk  
 Mr Burger  
 Mr Moore  
 Mr Robson

Mr Scholar  
 Mr Turnbull  
 Mrs Brown  
 Mr Colman  
 Mr Parkerson  
 Mr Hood  
 Mr C.A. Jones  
 Mr Cropper  
 Mr Tyllie

Treasury Chambers, Parliament Street, SW1P 3AG

Giles Shaw Esq MP  
 Minister of State for Industry  
 Department of Trade and Industry  
 1 - 19 Victoria Street  
 London  
 SW1H 0ET

*C/To be aware*

*CE 17/2*

<sup>44</sup>  
 16 February 1987

*pup  
wooded by AOX*

*Dec 6/87*

**BRITISH SHIPBUILDERS: EXTERNAL FINANCE LIMIT**

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*Yours ever,  
JH*

JOHN MacGREGOR

Tony  
28

DEPARTMENT OF TRANSPORT  
2 MARSHAM STREET LONDON SW1P 3EB

01-212 3434

Our ref: JM/PSO/1085/87

David Norgrove Esq  
Private Secretary to the  
Prime Minister  
10 Downing Street  
LONDON  
SW1

H/EXCHEQUER	
RECV:	24 FEB 1987 24/2
ACTION	FST
COPIES TO	

20 Feb. 1987

Dear David

You copied to me your letter of 29 January to Tony Kuczys at the Treasury, enclosing a copy of a further letter from the President of the General Council of British Shipping to the Prime Minister. The enclosed draft reply for the Prime Minister's signature has been cleared with Treasury officials. It presumes that the Prime Minister does not want to meet the GCBS now. She has not we think met them since July 1984.

I am copying this letter to Tony Kuczys at the Treasury.

Yours sincerely

Jenny McCusker

JENNY McCUSKER  
Private Secretary

The Hon W G Runciman  
President  
General Council of British Shipping  
30/32 St Mary Axe  
London EC3A 8ET

Thank you for your letter of 27 January about accelerated capital allowances for ships.

The strategic need for a merchant fleet has to be assessed in NATO terms, and the proposed study I referred to in my earlier letter is one of NATO's needs and resources, to be undertaken by NATO. Such a study does not of course preclude action before it is completed. The Secretary of State for Transport announced in December his intention to pursue three measures aimed at manpower needs, and NATO member states in a report from the Planning Board for Ocean Shipping to the Atlantic Council have pointed to the need for member states to take account in their shipping policies of the difficulties that may emerge for the Alliance. But the civil supply position of the Alliance overall in a war would be complex, and answers to questions about the types and numbers of ships that might fall short of requirements are not straightforward. Major action on a shortfall would have to be seen and planned as a contribution to the Alliance's resources, not just a national measure.

You have argued that your members are not seeking favours for their commercial interests but registering their concern about the strategic and defence implications of the reduction of the UK-registered fleet, and this I accept. On that basis I am surprised at the emphasis you have placed in both your letters

on the superiority of front-loaded capital allowances over cash subsidies as a means of ensuring the availability of British ships in an emergency. Both would be objectionable distortions of the market, and the differences between them are more matters of economic and political considerations than strategic need.

As high crew costs are an important reason for the decline in the UK merchant fleet, a cash subsidy might be more efficient than higher allowances in maintaining the supply of ships. Subsidies would be easier to target at particular vessels, and their cost would be more explicit than that of accelerated allowances.

I have noted and will keep in mind your offer to discuss these issues.



MINISTRY OF DEFENCE  
MAIN BUILDING WHITEHALL LONDON SW1

Telephone 01-~~3307222~~ 218 2111/3

CH/EXCHEQUE	
REC.	25 FEB 1987
ACTION	CST
COPIES TO	

MO 26/3/3V

24th February 1987

*Dee David*

BRITISH SHIPBUILDERS

The Defence Secretary has now seen a copy of your letter of 12th February to Michael Gilbertson about a proposed E(A) meeting on shipbuilding, which asks for a paper by the Ministry of Defence on the warship yards.

As you will be aware from other correspondence, we are currently reviewing the forward defence programme and Mr Younger does not expect to be in a position to put his conclusions to colleagues until after Easter. Whilst he can therefore offer a factual assessment for the purposes of the discussion on British Shipbuilders, Mr Younger hopes that the Prime Minister will understand the difficulty of having a substantive discussion of prospects for the warship yards in the timescale proposed.

I am sending copies of this letter to Alex Allan (HM Treasury), Tony Galsworthy (Foreign and Commonwealth Office), Andrew Lansley (Chancellor of the Duchy of Lancaster's Office), Robert Gordon (Scottish Office), John Turner (Department of Employment), Michael Gilbertson (Department of Trade and Industry) and Trevor Woolley (Cabinet Office).

*[Handwritten signature]*  
(I C F ANDREWS)  
Private Secretary

David Norgrove Esq  
No 10 Downing Street



MINISTRY OF DEFENCE

MAIN BUILDING WHITEHALL LONDON SW1

CHIEF SECRETARY Telephone 01-300 2222 218 2111/3

REC. 25 FEB 1987

CST Mr Hood.

EX FST Sir Peter Middleto

Mr Butler Mr Anson

Mr Monch Mr Bugner

Mr Moore Mr Robson

24th February 1987

Mr Schlar Mr Turnbull

Mrs Brown Mr Colman

Mr Cropper Mr Tyrre

MO 26/3/3V

Dae David

BRITISH SHIPBUILDERS

The Defence Secretary has now seen a copy of your letter of 12th February to Michael Gilbertson about a proposed E(A) meeting on shipbuilding, which asks for a paper by the Ministry of Defence on the warship yards.

As you will be aware from other correspondence, we are currently reviewing the forward defence programme and Mr Younger does not expect to be in a position to put his conclusions to colleagues until after Easter. Whilst he can therefore offer a factual assessment for the purposes of the discussion on British Shipbuilders, Mr Younger hopes that the Prime Minister will understand the difficulty of having a substantive discussion of prospects for the warship yards in the timescale proposed.

I am sending copies of this letter to Alex Allan (HM Treasury), Tony Galsworthy (Foreign and Commonwealth Office), Andrew Lansley (Chancellor of the Duchy of Lancaster's Office), Robert Gordon (Scottish Office), John Turner (Department of Employment), Michael Gilbertson (Department of Trade and Industry) and Trevor Woolley (Cabinet Office).

I. C. F. ANDREWS  
Private Secretary

David Norgrove Esq  
No 10 Downing Street



28

10 DOWNING STREET

LONDON SW1A 2AA

THE PRIME MINISTER

25 February 1987

CH/EXCHEQUE	
REC.	25 FEB 1987
<del>ACTION</del>	FST
COPIES TO	

Dear Mr. Ruzinca,

Thank you for your letter of 27 January about accelerated capital allowances for ships.

The strategic need for a merchant fleet has to be assessed in NATO terms, and the proposed study I mentioned in my earlier letter would be by NATO and would consider NATO's needs and resources. A study does not of course preclude action before it is completed, and the Secretary of State for Transport announced in December his intention to pursue three measures aimed at meeting manpower needs. But the civil supply position of the Alliance overall in a war would be complex, and answers to questions about the types and numbers of ships that might fall short of requirements are not straightforward. Major action on a shortfall would have to be seen and planned as a contribution to the Alliance's resources, not solely as a national measure.

You have argued that your members are not seeking favours for their commercial interests but registering their concern about the strategic and defence implications of the reduction of the UK-registered fleet, and this I accept. I am, however, surprised by the emphasis you have placed in both your letters on the superiority of front-loaded capital



allowances over cash subsidies as a means of ensuring the availability of British ships in an emergency. The differences between them are more economic and political than strategic, and both would of course distort the market.

I have noted and will keep in mind your offer to discuss these issues.

Yours sincerely

Raymond Stalder

The Hon. W.G. Runciman



b/f with  
address (P)

10 DOWNING STREET  
LONDON SW1A 2AA

*From the Private Secretary*

5 March 1987

Dear Tony,

I attach a copy of a letter the Prime Minister has received from The Hon W G Runciman.

I should be grateful if you could provide a draft reply for the Prime Minister's signature, to reach me by 19 March.

I am copying this letter to Richard Allan (Department of Transport).

Yours,  
David.

DAVID NORNGROVE

A. W. Kuczys, Esq.,  
H M Treasury

PRESIDENT:

THE HON. W.G. RUNCIMAN, C.B.E.

Telephone 01-283 2922

GENERAL COUNCIL OF BRITISH SHIPPING

30-32 ST. MARY AXE

LONDON, EC3A 8ET

3rd March, 1987

The Rt. Hon. Margaret Thatcher, MP.,  
Prime Minister,  
10, Downing Street,  
London, S.W.1.

*Handwritten initials: "R4" and "ms"*

*Dear Prime Minister*

Thank you for your reply to my letter of 27th January about accelerated capital allowances for ships.

I am not seeking to prolong our correspondence further and I welcome your recognition that Government action could be taken before the completion of the proposed NATO study. I do, however, want to put formally on record the reasons for the emphasis which I have placed in my letters on the superiority of front-loaded capital allowances over cash subsidies as a means of assuring the availability of British ships for defence and strategic purposes. Cash subsidies can, of course, be used to keep merchant shipping available, and the differences between them and capital allowances are, as you say, more economic and political than strategic. But the advantages of allowances are, in my belief, decisive for the following reasons:-

- (i) ships built or bought with the help of accelerated capital allowances are built or bought to make profit for their owners. Between 1975 and 1984, when some 30 mn. dwt of obsolete and uneconomic ships left the UK owned and registered fleet, some 12 mn. dwt of modern tonnage were ordered by British owners with the aid of the favourable tax regime then available. Some, but by no means all, of these ships have since been sold or flagged out for commercial reasons, but the remainder still form the core of our surviving fleet. By contrast in 1985 orders were placed by British owners for only 12 new ships totalling 27,000 dwt, and in 1986 for only two new ships totalling 4 thousand dwt;
- (ii) there can be no question that the cost to the taxpayer of cash subsidies would be a very great deal higher than the cost of deferment of tax on the same ships. Tax allowances "cost" the Exchequer a once for all deferment of tax, and then only if the company concerned makes profits. Subsidies are paid out year by year whether the initial investment proves to be wise or foolish;

CH/EXCHEQUER	
REC.	6 MAR 1987
ACTION	FST
COPIES TO	

- (iii) introduction of cash subsidies would introduce major and lasting inefficiencies into the ship market, as the example of the United States abundantly demonstrates;
- (iv) by the time that Government has recourse to subsidies it could well be too late, even with the help of the measures proposed by John Moore, for the right ships and the right crews to be there to be called on;
- (v) finally, tax allowances preserve an arm's length relationship between private enterprise and Government, whereas subsidies do not.

Yours sincerely

W. D. Sullivan

UNCLASSIFIED



(needed)  
RF

CC Chancellor  
CST  
EST  
MST  
Sir P. Middleton  
MR FER Butler

Treasury Chambers, Parliament Street, SW1P 3AG

MR Anson  
MR Cassell  
MR Scholar  
MR S. Robson  
MR G. Moore  
MS Seaman  
Miss Sinclair  
MR Revolta  
MR Milner  
MR Crupper  
MR Driscoll A/S/R

David Norgrove Esq  
Private Secretary  
10 Downing Street  
London SW1A 2AA

11 March 1987

Dear David,

**MR RUNCIMAN OF THE GCBS: ACCELERATED CORPORATION TAX CAPITAL ALLOWANCES**

Mr Runciman wrote for the third time to the Prime Minister on 3 March saying that he was not seeking to prolong the correspondence but there were a few points he wished to record. He believes that merchant shipping requires Government assistance and that that assistance would be better channelled through accelerated capital allowances rather than operating subsidies.

We do not agree that there is a case for Government assistance on defence or civil resupply grounds, though the situation must be kept under review and the NATO study of supply and demand is important. Nor do we agree that accelerated allowances would be a 'better' way of giving assistance than operating subsidy; they are equally a cost to the Exchequer and subsidies can be targeted.

These views have already been exchanged. We have considered the desirability of rising to Mr Runciman's latest points but on balance, think it best to accept Mr Runciman's suggestion and let the correspondence rest. You might send a brief acknowledgement on the lines:

The Prime Minister has asked me to thank you for the informative exchange of views resting with your letter of 3 March.

I am copying this letter to Richard Allan in the Secretary of State for Transport's Office.

Yours sincerely,

*Nigel Williams*

**NIGEL WILLIAMS**

FROM: JIM MILNER

DATE: 11 March 1987

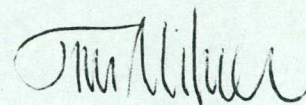
1. MR REVOLTA
2. PS/FINANCIAL SECRETARY

I agree. The GCBS case  
 does not merit any more  
 Prime Ministerial time,  
 and has if anything  
 been given too much  
 evidence already. *or 11/3*

cc PS/Chancellor  
 PS/Chief Secretary  
 PS/Economic Secretary  
 PS/Minister of State  
 Sir Peter Middleton  
 Mr F E R Butler  
 Mr Anson  
 Mr Cassell  
 Mr Scholar  
 Mr S Robson  
 Mr Gilmore  
 Ms Seammen  
 Miss Sinclair  
 Mr Cropper  
 PS/Inland Revenue  
 Mr Driscoll (CIR)

PRIME MINISTER'S CORRESPONDENCE WITH THE PRESIDENT OF THE GENERAL COUNCIL OF  
 BRITISH SHIPPING: CORPORATION TAX ACCELERATED CAPITAL ALLOWANCES AND DEFENCE

1. Mr Runciman, President of the GCBS, wrote to the Prime Minister for a third time on 3 March to put on record five points in support of the case already addressed in previous exchanges.
2. I attach a draft letter to the Prime Minister's Private Secretary recommending a brief acknowledgement.



JIM MILNER

HE1

x 4722

DRAFT LETTER FROM THE PRIVATE SECRETARY TO THE FINANCIAL SECRETARY  
TO DAVID NORGROVE, PRIVATE SECRETARY TO THE PRIME MINISTER

MR RUNCIMAN OF THE GCBS: ACCELERATED CORPORATION TAX CAPITAL  
ALLOWANCES

1. Mr Runciman wrote for the third time to the Prime Minister on 3 March saying that he was not seeking to prolong the correspondence but there were a few points he wished to record. He believes that merchant shipping requires Government assistance and that that assistance would be better channelled through accelerated capital allowances rather than operating subsidies.
2. We do not agree that there is a case for Government assistance on defence or civil resupply grounds, though the situation must be kept under review and the NATO study of supply and demand is important. Nor do we agree that accelerated allowances would be a 'better' way of giving assistance than operating subsidy; they are equally a cost to the Exchequer and subsidies can be targetted.
3. These views have already been exchanged. We have considered the desirability of rising to Mr Runciman's latest points but on balance, think it best to accept Mr Runciman's suggestion and let the correspondence rest. You might send a brief acknowledgement on the lines:

The Prime Minister has asked me to thank you for the informative exchange of views resting with your letter of 3 March.

4. I am copying this letter to Richard Allan in the Secretary of State for Transport's Office.



DEPARTMENT OF TRADE AND INDUSTRY  
1-19 VICTORIA STREET  
LONDON SW1H 0ET

Telephone (Direct dialling) 01-215 5422  
GTN 215 .....  
(Switchboard) 01-215 7877

PS/ Secretary of State for Trade and Industry

APPOINTMENTS IN CONFIDENCE

13 April 1987

David Norgrove Esq  
Private Secretary to the  
Prime Minister  
10 Downing Street  
London SW1A 2AA

CHIEF SECRETARY	
REC.	13 APR 1987
ACTION	MR MART
TO	CX EST MST EST
	Sir Peter Middleton
	Mr Butler Mr Kemp
	Mr Maud Mr Bugner

MR Colman MR Gilhooly  
MR Cropper MR Tyrie

Dear David,

MR Moore MR Scholar  
MR Turnbull MRS Brown

CHAIRMANSHIP OF BRITISH SHIPBUILDERS

As the Prime Minister will know, Phillip Hares the Chairman and Chief Executive of British Shipbuilders has been ill since early this year. He has now decided with my Secretary of State's full agreement to take early retirement on health grounds from 1 May.

My Secretary of State has decided that it would be right to bring in an experienced and competent manager from outside the industry to lead British Shipbuilders through the next difficult few years. He has therefore decided that he would like to appoint as Chairman and Chief Executive Mr John Lister (Age 56) who has just retired as Chairman of ICI Fibres. The appointment would run for 3 years from 1 May. Mr Lister is a tough and pragmatic manager who made a very substantial impact in turning around ICI's fibre business. He originally trained as a chemical engineer and has worked with ICI all his life.

As to salary, Mr Lister is content to start at the same salary as Mr Hares (that is to say £65,000 plus a non-pensionable performance bonus of up to 15% of salary on terms to be agreed). As far as pension is concerned, Mr Lister needs to consult his financial advisers, but it is believed that he will ask for arrangements well within the normal limits. Officials will deal direct with the Treasury on this aspect.

JG1BAI





Sir Robert Armstrong and Sir Peter Middleton agreed that we could approach Mr Lister.

My Secretary of State would wish if possible to announce Mr Hares' retirement and Mr Lister's appointment on Wednesday 22 April. It would be most helpful if you could confirm by Thursday morning (16 April) the Prime Minister's agreement to the appointment, and if Jill Rutter could confirm by the same time that the Chief Secretary is content with the terms and conditions of appointment.

I am copying this letter to the Private Secretaries to the Lord President of the Council, the Chief Secretary and Sir Robert Armstrong.

*Yours ever*

*Paul*

PAUL STEEPLES  
Private Secretary

JG1BAI

SECRET

JT



Ch,  
We have commissioned  
briefing on this for your  
meeting on 27/10.  
20/10

EX/CHEQUER	
REC.	20 OCT 1987 20/10
CST	
COPIES TO	

TO:  
PRIME MINISTER

FROM:  
KENNETH CLARKE  
20 October 1987

*Handwritten signature*

I spoke to Nigel about  
this. Although it says  
"CST" it is really for us  
(see X below). Pse. ensure  
that Mr Colman sends  
no briefing by 23/10.  
21/10

**BRITISH SHIPBUILDERS**

1 As you know, I have been considering the future of British Shipbuilders (BS) in the light of the Corporation's strategy document which I received last month. I have come to the conclusion that the only sensible solution is to close down BS as fast as possible and to make substantial new efforts to help establish alternative employment and enterprise which can offer a real future to the communities affected, notably on the Clyde and in Sunderland. The arguments are set out in the attached draft paper for E(A) for discussion initially with you, Willie Whitelaw, David Young and Nigel Lawson on 27 October.



2 I am particularly keen that we should look at this alongside the future of British Steel Corporation (BSC). We will also need to think about how Harland and Wolff fit into the picture.

3 As far as both BS and BSC are concerned, it seems to me vital that we should at the time of any announcement be in a position to point to a package of measures to create new jobs and enterprise in the communities concerned. To be convincing any such package will need to include not only new initiatives and have a credible delivery mechanism, such as the one described in my minute of 24 July on BSC, but will need to demonstrate significant financial backing. I will return to this point when I write to you shortly about my detailed proposals for BSC.

4 It is important that we should convince at least the younger people in the affected shipbuilding communities that they will be better off in jobs and enterprises with a real future rather than in ones which depend on continuing subsidy and a highly uncertain market. This will be especially important if BS is to complete its existing workload, including notably the ships for China, with the minimum of disruption. I



will be emphasising to John Lister, the Chairman of BS, the importance we attach to the successful completion of the China order.

5 The timing of any announcement on BS and BSC is difficult. David Young and I see advantage in this not being until February, after we have relaunched the Department's programmes based on the provision of services rather than automatic grants. This would enable us to present our decisions as part of a consistent forward-looking strategy. There would, however, be difficulties in keeping to such a timetable, eg in the case of BSC there are European discussions throughout November and in early December. We will also need to consider the position of our colleagues. I will let you have my further thoughts on this when we meet.

6 We also need to consider the relationships between an announcement on BS and the future of Harland and Wolff. I have talked to Tom King and he prefers to allow Harlands to finish their existing workload (including AOR 01) but would prefer to make no announcement for some time. While this decision would parallel my preferred approach for BS (to allow the yard to close as work runs out) it will be very difficult to postpone an announcement indefinitely.



7 I am copying this minute and enclosures to Willie Whitelaw,  
David Young and Nigel Lawson.

*K*

KENNETH CLARKE

E(A)(87)

DRAFT

THE FUTURE OF BRITISH SHIPBUILDERSA Memorandum by the Chancellor of the Duchy of LancasterIntroduction and Summary

1 I have received a Strategy Paper from John Lister, British Shipbuilders' new Chairman. He has identified four options:

1. Close all yards as work runs out.
2. Close Govan and build-up North East Shipbuilders at Sunderland to double the present workforce.
3. Keep Govan and NESL.
4. Close one yard, probably Govan and keep the other at its current size.

2 Although the merchant shipbuilding market is likely to be stronger in the 1990's, only the closure option removes the prospect of British Shipbuilders needing support on a lasting basis. There is no realistic prospect of BS ever becoming commercially viable. I conclude our choice should be Option 1. We have to take steps now to create new jobs instead.

## The Merchant Shipbuilding Market

3 While the signs are that new building capacity will continue to fall, the market is likely to be stronger in the early 1990's because considerable numbers of ships that were built during the 1970's will fall to be replaced during the decade. As compared with the recent trough, when even South Korea was almost certainly building at a loss, there is bound to be a significant recovery in prices. There are already signs that market recovery is underway, and closure might take place against a background of some further improvement. Even so, the best that can be said is that there is some prospect of market balance by the early 1990's, but it is not possible to be precise about timing.

Notwithstanding the considerable replacement demand that is likely in the 1990's, the shipbuilding market is likely to remain vulnerable to long periods of excess capacity. Annex A expands the argument.

## Options

4 The Options are described and costed in Annex B. BS prefer Option 3 in which present capacity is retained. Mr Lister sees this as sufficient to allow an effective specialist business to be developed in medium sized ships based on the present two large yards. Preparations would be made to privatise other parts of BS as conditions allowed. The trouble is that Option 3 would still cost some £10,000 per BS employee a year in the early 1990's after allowing for some improvement in the market. And even on

much more favourable market assumptions, including another peak in the shipbuilding cycle, BS would only have the prospect of making any money for a period of two to three years in the 1990's, after which they would almost certainly need substantial support again. This is despite their forecasting a significant though realistic improvement in operating efficiency, and an increased focus on the market which the new Chairman is already bringing into effect.

5 I do not regard Options 2 and 4 as runners. Option 2 seeks to develop a business of sufficient size on a single site which would almost certainly be NESL because of its flexibility. This would have all the political problems of closing Govan on the Clyde with no financial advantages as it contemplates heavy public expenditure on the Sunderland yards. The BS Board do not see Option 4 as making commercial sense. They fear that no one in BS would believe that that was where contraction would stop, making it very difficult to retain or motivate key personnel. They also doubt that NESL as it is could generate enough cash to support overhead expenditure. I agree with the very clear advice of the BS Board that, if we do not find Option 3 attractive, the business should close. I regret to say that I feel closure is the right decision whilst BS, understandably, would like to carry on with Option 3.

6 If Option 3 might cost some £340m over the next four years as compared with an IFR forecast of £378m, closure - Option 1 - would bring with it total Exchequer costs of some £450m. However, that would be the end of the matter, whereas I do not



believe that there is any prospect of BS continuing without substantial support looking forward over the 1990's as a whole, requiring perhaps a further £300m-£700m over the decade, depending on the market. In my opinion, Option 3 is the course which Mr Micawber would recommend. We would be continuing much as now in the faint hope that something might turn up to reduce the cost.

7 Finally, although Option 1 would not give rise to difficulties in Brussels, the support levels envisaged in Option 3 would seriously breach the Sixth Directive and require an accommodation from the Commission, which might well not be forthcoming.

#### Employment Consequences

8 BS now employ 6300 people. There are 2500 at North East Shipbuilders (NESL) at Sunderland and 1745 at Govan, the two main yards; 530 at Appledore in Devon and 315 at Ferguson at Greenock, the small ship yards; 640 at Service Companies at Sunderland; and 90 in HQ and Central Services.

9 Annex C charts the likely course of redundancies under Option 1. Substantial numbers would start to leave NESL by mid-1988 when work on the Danish Ferries starts to run out. The smaller facilities could start losing people quite soon, even if they were to be privatised. Redundancies at Govan begin in 1989. Final redundancies fall in 1990 in both major yards.

## Manageability

10 There are two major considerations:

- Whether BS can achieve a run-down with acceptable disruption to present orders
- What we can put in place of the 6300 or so jobs that are bound to be lost, not forgetting additional jobs in supplying industries.

11 BS have warned that closure will be difficult to manage and could well involve considerable industrial disruption. BS will need to make a major effort to persuade the workforce and the management to stay the course for long enough to complete the orders, particularly at Govan where they will have two or three ships for China. BS recognise that substantial bonuses will be needed.

12 But both to minimise difficulties and to gain acceptance for the necessity of closing British Shipbuilders we will need to demonstrate that there is a real productive alternative future for the communities concerned. This we must do in any event. To this end, we need to be prepared to commit substantial amounts of money on the Clyde, in Sunderland and in North Devon and be ready to announce a convincing package of measures designed to encourage new business prospects and employment in these areas. The Official Group on Measures to Alleviate Major Redundancies is working up some ideas.

working up some ideas.

13 It may be possible for BS to transfer some of its activities to the private sector saving some jobs (perhaps 200 at Clark Kincaid in Greenock which is a good general engineering facility; 100 at Marine Design Consultants in Sunderland; and 100 to 200 at Sunderland Forge Services). Otherwise, the outlook is bleak, though I would not wholly rule out the possibility of privatising either Appledore or Ferguson who make small ships if they can survive until 1989 and the market recovery is then strong. But this would require us to allow Appledore to take up to 2 further dredger orders if they can win them in the next few months because their order book runs out in June 1988. The net cost of this would be £9m.

#### Presentation

14 In announcing our decision, we would have to say we had ploughed considerable sums into this industry, close on £1500 million since 1979 on BS merchant shipbuilding alone, ending up, as we are today, with a business employing only 6300 people. The cost has been £9,000 per employee per year throughout the period (even excluding redundancy costs) and despite the probable improvement in the market, support at around this level, though perhaps with fluctuations, would continue to be needed for the foreseeable future. We see no serious prospect of British Shipbuilders ever becoming commercially viable. Our accompanying package of measures would be designed to persuade people on the Clyde and the Wear to look away from a dying

industry and part of their industrial past and to look instead to new and profitable enterprises on which to build their future. We would have to show considerable Government support for efforts to build a new industrial base in those areas.

### Legislation

15 Although we have the power to run-down the operations of BS subsidiaries, we should need primary legislation to wind-up the Corporation. This would need to go through the House during the period of run-down over the next two years.

### British Shipbuilders External Financing Limit (EFL)

16 A new provisional baseline for BS's EFL has been agreed with the Chief Secretary and will be incorporated into the Public Expenditure White Paper figures. But the figures will need to be revised in the light of our decision and I propose to agree them subsequently with the Chief Secretary.

### Private Sector

17 There are a number of small private sector yards that are eligible for Intervention Fund support for new orders in equity for that given to British Shipbuilders and Harland and Wolff. Once more, this expenditure does not make much sense in industrial or employment policy terms. I believe we should reduce the limits on Intervention Fund support for all small

ships, whatever we decide about BS, because private sector support has become increasingly expensive, and most of the relevant employment in BS and the private sector is outside the Assisted Areas. On present forecasts, support for private sector merchant shipbuilding could cost £18m over the next three years, £10.4m above the PES baseline in support of only some 500 jobs. Any reduction will of course put many of these jobs at risk.

### Recommendations

18 I invite my colleagues to agree that

1. All BS facilities should be closed or disposed of as soon as present work runs out (though Appledore should be allowed to take 2 further dredger orders if it can do so by [March 1988]).
2. We should make substantial sums available for a package of measures designed to encourage new enterprise and employment in Govan and Sunderland in particular.
3. Intervention Fund support for small ships affecting private sector yards as well as BS should be reduced to keep the cost within the PES baseline.

SECRET

BF 26/10

FROM: J G COLMAN

DATE: 23 October 1987

CHANCELLOR

cc Chief Secretary  
Financial Secretary  
Mr F E R Butler  
Mr Monck  
Mr Burgner  
Mr D J L Moore  
Mr A White  
Mr Hood  
Mr P Morgan  
Mr Call

**BRITISH SHIPBUILDERS**

Mr Kenneth Clarke's minute of 20 October to the Prime Minister explains that he wishes to discuss his proposals for the future of BS at the meeting already arranged on 27 October to discuss the future of the British Steel Corporation.

2. The purpose of discussing BS at that meeting is as follows:

- a. to ensure that the Prime Minister will support Mr Clarke's proposal to wind up BS;

and, on the assumption that she will;

- b. to consider the handling of that decision and the likely decisions on BSC and on Harland and Wolff.

**Comment**

3. Although we think that Mr Clarke is right to conclude that BS should close, it would not have been difficult for him to construct reasons for choosing Option 3. Mr Rifkind will certainly deploy the arguments, which are as follows:

- a. the shipbuilding market is turning up.

SECRET

- b. there is a good chance over the 1990s of the prices being determined not by South Korea (whose yards will be full) but by Japan (whose costs are now comparable to BS because of the strength of the Yen). In these circumstances BS could be profitable;
- c. the new chairman should be given his head;
- d. Option 1 will involve closing yards just when the market will be taking off, and just before the next Election;
- e. closing Govan, in particular, will be a very high profile act, is it really necessary?
- f. Option 1 is very expensive over the next 3 years.

These arguments carry no weight unless one is prepared to believe both (b) and (c): that is, that there will be a profitable market and that Mr Lister will be able to turn round BS's management to exploit it profitably. Our bitter experience of BS leads us and Mr Clarke to doubt both.

Arguments for closure

4. We therefore recommend you to support strongly the proposal to close BS. Mr Lister, the new chairman of BS, has examined 4 Options:

1. close all yards.
2. close one yard (Govan) and build up the other (NESL)
3. keep both Govan and NESL
4. close one yard (probably Govan) and keep the other at its current size.

5. Mr Lister believes that Options 2 and 4 are non-starters. We and Mr Clarke agree for the reasons given in paragraph 5 of his draft paper. So the real choice is between closure and option 3. As in the case of Harland and Wolff, there is a choice in the closure option between immediate closure and closure as work runs out. Mr Clarke, like Mr King, favours the soft-landing. There is no economic rationale for that approach, which we recommend you to oppose.

6. The key arguments for closure are as follows:

- a. there is no strategic case for the UK to maintain a merchant shipbuilding industry which is not commercially viable. This was the conclusion of last year's report by officials (MISC 127) which no-one has challenged.
- b. the best that can be said for the shipbuilding market is that there is some prospect of market balance by the early 1990s (paragraph 3 of Mr Clarke's draft paper).

This would be the cyclical peak. Only on the most optimistic of Mr Lister's scenarios would BS's financial requirement fall to approximately nil at that peak. BS would need substantial support after the 2-3 years which it might last (paragraph 4).

- c. although closure would in the first 3 years cost the Exchequer some £100m more than Option 3, that option would cost £300m-£700m thereafter (paragraph 6)
- d. Option 3 requires support levels far higher than Brussels has previously contemplated: it may well not be possible to get agreement to such levels of support (paragraph 7).



Rate of closure

7. BS's current workload is being built at prices which are less than the cost of the raw materials: merchant shipbuilding by BS has negative value-added. The economic argument points clearly to immediate closure.

8. The financial implications of immediate closure would only be determined by negotiation with the shipowners whose work was under construction at the time. It would probably be more expensive to close now rather than to complete the current workload, but the option of completing the workload may not be achievable in practice. The so-called "last ship syndrome" is likely to give rise to extra costs and industrial disruption. It would be very likely that BS would lose many of its skilled management who were employable elsewhere - which of itself would increase the risks of gradual closure. And the combination of all these risks could well result in BS not being able to complete all the ships. In that event the payments to shipowners would be higher than those due if the contracts were cancelled now.

9. One supposed advantage of gradual closure is its lower political profile. That depends on closure not being announced but gradually becoming apparent as the work runs out. But the shipbuilding market is turning up, and it is quite possible that if closure is not announced BS may well win further orders. Gradual closure on the original timetable would then only be possible if BS were told to refuse to accept new orders - a very high profile act, which might have to be done much nearer to the next Election than now. In fact Mr Clarke acknowledged that an announcement will be necessary (not least because legislation will be required to wind up BS). In that event the arguments on the relative timing of actual closure of yards and the market upturn - paragraph 3d above - point to early announcement of immediate closure.

10. DTI Ministers' main reason for rejecting the option of immediate closure is as follows. Govan's workload comprises the two ships for China which Ministers collectively agreed to let BS bid for before the Election. The Prime Minister subsequently intervened personally with the Chinese to help secure the orders. DTI Ministers think it would be most embarrassing to have to tell the Chinese now that the deal is off.

#### Employment measures

11. I discuss this issue more fully in a separate brief on BSC. For the purpose of the meeting on 27 October, we recommend that you should do no more than say that the Treasury will want to look closely at the detailed proposals for employment measures when these emerge, and that the response to the problems in Glasgow and the North East should not be disproportionate to the real problem. The numbers of jobs lost are not large by comparison with job losses in the past or to come elsewhere (eg Devonport, BREL).

#### Position on Harland and Wolff

12. In his paper to EA on 17 September (EA(87)31) Mr King recognised closure as inevitable but argued for 'soft landing' with closure after completion of AOR OI in early 1990. In discussion the Chief Secretary pressed for an early closure, with AOR OI being transferred elsewhere (probably Swan Hunter). Final decisions were deferred until the Committee had been able to consider the BS Corporate Plan. It is likely that Mr King will continue to argue for a 'soft landing' approach and it would be difficult to resist that if Mr Clarke's proposals for British Shipbuilders were accepted.

13. That said, developments since EA's September discussion add strength to the Chief Secretary's arguments. While H&W believe that they can live with the increased EFL agreed for 1987-88 there are clear indications that the costs of Mr King's preferred approach are already beginning to rise. While is

SECRET

expected that the ATS being built for MOD will be completed by the end of the year, further slippage is arising on both the years other orders. The SWOPS vessel being built for BP is now unlikely to be completed until at least March 1989 (three months later than Mr King was assuming last month) and at a cost of £140m against proceeds from BP of £115m. On AOR OI, where work is at a very early stage, it is now likely that completion would not be possible before end 1990 (nine months later than Mr King was assuming last month). A cost overrun is clearly in prospect of at least £16m - a level high enough to trigger penalty provisions in H&W's contract with MOD.

14. Although there has now been some strengthening of H&W's management it is difficult to see Mr King's 'soft landing' as being anything other than a long drawn out and costly exercise. You should make it clear that when H&W comes before EA you will be pressing strongly for early closure and that the evidence already emerging on H&W indicates how rapidly slippage can develop and costs begin to escalate in a yard that has received no new orders for some time, even though there is work in hand and no decision has been taken let alone announced on closure.

#### Announcements

15. Mr Clarke is non-committal on this because, I understand, he has yet to make up his mind what he wishes to propose. I shall discuss this issue more fully in my separate brief on BSC.

#### Other issues

16. Mr Clarke proposes to extend the life of the small BS Appledore yard in Devon, at a cost of £9m by allowing them to accept two orders for dredgers. The case for this is that closure of the Appledore yard would increase the unemployment

SECRET

rate by a very high percentage (but to a slightly lower level than that in the North East), and that Appledore is remote from alternative sources of employment. It is in the constituency of Miss Emma Nicholson. None of this amounts to a very strong case.

J. G. C.

J G COLMAN

SECRET

FROM: J G COLMAN

DATE: 26 October 1987

CHANCELLOR

cc Chief Secretary  
Financial Secretary  
Mr F E R Butler  
Mr Monck  
Mr Burgner  
Mr D J L Moore  
Mr A White  
Mr Hood  
Mr P Morgan

Mr Call

**BRITISH SHIPBUILDERS**

This supplements the briefing I submitted on 23 October, in paragraphs 7-10 of which I discussed the case for and against immediate closure.

2. A key issue is the Chinese order. The present position is that BS and the Chinese have agreed terms for the construction of 2 ships, but that the separate financing contract is not quite agreed. Additionally the Chinese have the option, which they are expected to exercise, of ordering a third ship on terms which have substantially been agreed.

3. The costings in Mr Clarke's draft E(A) (Option 1 - £450m over 3 years; option 3 - £340m for first 3 years) are, we understand, not quite on a consistent basis because the completion of 2 Chinese ships is assumed in Option 1, whilst Option 3 is based on 3 Chinese ships. It is necessary, also, to estimate what the costs would be under Option 1 if the Chinese ships were not completed (eg because of the last ship syndrome).

4. We understand that DTI have now made some estimates which show that immediate closure now would reduce the cost of Option 1 by several tens of millions of pounds, even if it is assumed that the Chinese ships would be completed. In the worst case assumption, in which 3 ships ordered and none is completed the cost of gradual closure would be even more.

5. DTI officials, although otherwise helpful to us, have been unwilling to reveal to us the detailed constings without specific authorisation by their Ministers. I suggest that you should take the following line at the meeting:

- a. acknowledge powerful political arguments for not cancelling the Chinese orders, but must know the cost of not doing so;
- b. what would be cost of cancelling Chinese order now?
- c. how much would completing the 3 ships add to the cost?
- d. what extra would it cost if none of these 3 could be finished?

6. [Not to be quoted]

We believe that the answers to the last 3 points are as follows:

- b. £20m
- c. £60+m
- d. £10-20m]

J.G.C.

J G COLMAN



FROM: JILL RUTTER  
DATE: 26 October 1987

PS/CHANCELLOR

cc:  
Financial Secretary  
Mr F E R Butler  
Mr Monck  
Mr Burgner  
Mr D J L Moore  
Mr Colman  
Mr A White  
Mr Hood  
Mr P Morgan  
Mr Call

*Agree*

**BRITISH SHIPBUILDERS**

The Chief Secretary has seen Mr Colman's brief for the Prime Minister's meeting on British Shipbuilders/BSC on 27 October.

2 The Chief Secretary has commented that he is sure that eventual closure is inevitable and that the early closure option is right from the Public Expenditure viewpoint.

A handwritten signature in blue ink, appearing to read 'Jill Rutter', with a horizontal line underneath.

JILL RUTTER  
Private Secretary

*fmj*

FROM: J M G TAYLOR

DATE: 27 October 1987

PS/CHIEF SECRETARY

cc Financial Secretary

Mr F E R Butler

Mr Monck

Mr Burgner

Mr D J L Moore

Mr Colman

Mr A White

Mr Hood

Mr P Morgan

Mr Call

**BRITISH SHIPBUILDERS**

The Chancellor has seen your minute of 26 October. He agrees with the Chief Secretary's view that eventual closure is inevitable, and that the early closure option is right from the Public Expenditure viewpoint.

*CR**PP* J M G TAYLOR





10 DOWNING STREET  
LONDON SW1A 2AA

2 November 1987

CH/EXCHEQUER	
	4 NOV 1987
ACTION	Mr DJ L Moore
COPIES TO	EST CST
	Sir P Middleton
	Mr Mand
	Mr Culman

From the Private Secretary

cc Mr Burgner  
 Ms Sedman  
 Mr A M White  
 Dear Peter,

SHIPBUILDING

The Prime Minister thinks it would be useful fairly soon to hold a small meeting on the future of shipbuilding, following the meeting on Harland and Wolff which took place on 17 September. She would accordingly be grateful if the Chancellor of the Duchy of Lancaster could circulate a note about the prospects for British Shipbuilders, and the Secretary of State for Northern Ireland an updated note about Harland and Wolff and the AOR 1. It would be helpful if the Ministry of Defence could include in one or other of these notes an updated description of the position and prospects of the warship yards.

I am copying this letter to Mike Eland (Lord President's Office), Alex Allan (HM Treasury), John Howe (Ministry of Defence), David Crawley (Scottish Office), David Watkins (Northern Ireland Office), Tim Walker (Department of Trade and Industry) and Trevor Woolley (Cabinet Office).

John,  
 David.

David Norgrove

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



1. Jayathan

2. C/

You have a meeting to discuss Shipbuilding after Cabinet on Thursday. The original cast list included the Secs of State for Scotland, N. Ireland & Defence - but the PM decided not to have them at the meeting & so cancelled & re-instated it with just the Lord President, Ch Duchy Lanc, yourself & Sec of State for Trade & Ind.

No 10 would be grateful if we kept the existence of the meeting from the other Ministers at Cabinet etc.

Julie  
8/12.

JK



19/11  
FROM: MRS J THORPE  
DATE: 5 November 1987

MR D J L MOORE

cc: CST  
FST  
Sir P Middleton  
Mr Monck  
Mr Colman  
Mr Burgner  
Miss Seammen  
Mr A M White

**MEETING TO DISCUSS SHIPBUILDING**

The Chancellor will be attending a meeting at No.10 on Thursday 19 November at 9.30 am to discuss shipbuilding. Also attending are the Lord President, the Chancellor of the Duchy of Lancaster, Secretary of State for Scotland, the Secretary of State for Northern Ireland, and the Secretary of State for Defence.

2. I would be grateful if you could provide briefing by close of play on Tuesday 17 November.

*Julie Thorpe*

MRS JULIE THORPE  
Diary Secretary

SECRET



CH/EXCHEQUER	
REC.	10 NOV 1987
ACTION	DJK MOORE
COPIES TO	FST CST
	Sir P Middleton
	Mr Menck Mr Burg
	Mr Colman
	Mr A M White
	Ms Seaman

*Put with app. for mib. 18/11*

TO:  
PRIME MINISTER

FROM:  
KENNETH CLARKE  
9 November 1987

**SHIPBUILDING**

1 As requested in David Norgrove's letter of 2 November, I attach a note on the prospects for British Shipbuilders for discussion at your meeting at 9.30 am on Thursday 19 November. This concludes that the prospects remain so poor that we should close the yards as the existing orders run out over the next two to three years and that we should make substantial sums available for a package of new measures designed to encourage new enterprise and employment in Sunderland and Govan in particular.

2 I also attach a note on the situation in the warship yards prepared by the Ministry of Defence. It updates the one circulated to E(A) in September with E(A)(87)30.



3 These two notes together underline the severe decline in jobs which we can expect both on the Clyde and in the North East. Scott Lithgow has already announced its intention to run down to a care and maintenance basis by next February.

4 In order to help mitigate the problems which a run-down of BS would cause, I have asked the Official Group on Measures to Alleviate the Effects of Major Redundancies to consider what might be done. I understand that their report will be available shortly and I hope it will contain some useful ideas for refocussing support, particularly in Sunderland and Govan.

5 But I doubt if what they propose will be sufficient for our purpose (they have not been aware of some of the wider ramifications). If we are successfully to wean the affected communities from their dependence on continuing subsidies for industries whose decline is inevitable, it is vital that we should be able to demonstrate publicly that there is a real alternative. To this end I propose that we should set up an enterprise company (or companies) in the affected regions.

6 The chief features of an enterprise company would be:



to become the focal point for the industrial regeneration of the most affected areas;

to have a substantial industry figure as its head and to involve, on a part-time basis, a few prominent industrialists;

to encompass the local activities of British Steel Corporation (Industry) (on enterprise) and British Shipbuilders Enterprise Ltd (on counselling, retraining and re-employment);

to develop large industrial parks in each affected area with a substantial promotional budget and to include managed workshops.

7 The proposal needs some further work to define its functions more precisely and to work out its relationship with bodies such as BSC(I) and BSEL. I think that a company which would be seen as an adequate response to the likely BS redundancies in the North East might need funding of some £36m over 5 years for retraining and enterprise activities plus



upwards of £60m over the same period for a business park.  
Malcolm Rifkind will wish to consider whether something of the  
same order would be appropriate in Scotland, although the  
position on steel will of course also be relevant.

8 I am copying this minute and enclosures to Willie Whitelaw,  
Nigel Lawson, David Young, Tom King, Malcolm Rifkind, and  
Sir Robert Armstrong.

*Julian Farrer*

pp KENNETH CLARKE

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

Ref: MH7AAB

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**THE SHIPBUILDING MARKET****Current Position**

1. The level of orders in 1986 was 9.4m cgt compared with estimated world capacity of 18m cgt presently available for new building. This demand is so low in relation to supply, and second hand ships in good condition are still so widely available, that new ships can only be sold at distress prices which bear little relation to building costs. BS believe that at current prices even low cost South Korean shipbuilders make heavy losses. At their current productivity and material cost levels the Corporation say substantial price rises are required before they can compete successfully in the open market, even with the current 28 percent support limit imposed by the EC.

**Future Prospects**

2. When considering future shipbuilding demand, supply and prices, BS have drawn heavily on published industry forecasts. These predict that gradual reductions in shipbuilding capacity and a recovery in demand due primarily to the need to replace an ageing world fleet will bring the market into balance sometime between 1989 and 1993. This is bound to be associated with an increase in prices. In the past, new building prices have doubled between troughs and peaks of the shipbuilding cycle. BS



point to several strands of evidence that suggest that recovery in the shipbuilding market is already underway. While they do not hazard an opinion as to the timing or shape of the cycle, they do believe the market during the 1990's will generally be more buoyant than in the 1980's because of considerable replacement demand and more realistic pricing by South Korea.

3. We note that only modest reductions in shipbuilding capacity are expected between now and 1990, and that much capacity which is presently mothballed or might become so; or is presently engaged in naval work, repair or rig-building could become available for merchant work in a better market. However, if the supply position is difficult to forecast, the demand side of the picture is even more uncertain. The best that can be said is that there is a reasonable prospect of market balance by the early 1990's, but it is not possible to be precise about timing. Notwithstanding the considerable replacement demand that is likely in the 1990's, the shipbuilding market is likely to remain vulnerable to long periods of excess capacity.

4. Even if market balance were restored by the early 1990's, there must be considerable doubts about subsequent market developments. Market improvement may encourage productivity improvement in existing yards and new investment, especially in developing countries; shipowners faced with higher prices may prolong the life of existing ships and seek to improve their productivity; and the future growth and structure of world trade is uncertain. Notwithstanding potentially large replacement demand in the 1990's, the shipbuilding market is likely to remain

vulnerable to long to periods of excess capacity. However, an earlier underlying shift in the dominant bulk trades towards shorter journeys is thought to be almost complete.

5. On prices, we agree with BS that there are early signs of market recovery in recent movements. Since the shipbuilding market has been subject to rapid swings in the past, there is certainly a risk that prices could improve considerably during the period of run down foreseen in Option 1. And although it is impossible to forecast the timing and shape of the next price peak in the shipbuilding cycle, peak prices in the 1990's could well be double those in the 1986 trough even if, as in the 1980 peak, world demand was still below available capacity. Thereafter, the more marked is the peak, the more cyclical subsequent price movements are likely to be.

6. Shipbuilding industry forecasts are based largely on demand for bulk capacity, tankers and bulk carriers, whereas BS can build both medium sized bulk and specialist vessels, and is likely to be more competitive in the latter, which tend to be a separate market. We nevertheless believe that prices for specialist vessels would increase with those for bulk capacity since, as Far East capacity becomes filled with bulk vessels, much of it replacement demand, European yards will be far better placed to dictate prices, and owners will be prepared to pay in the interests of securing early delivery in a rising market. Shipping rates can be expected to move in step.

7. Within the market, BS believe their costs are now broadly in line with those of Japanese and West German yards, all of which are substantially higher than the South Koreans by a margin of at least 20 percent. Once South Korean capacity is filled, BS argue that the Japanese and others with similar costs will be in a position to dictate market prices. We agree with this as the market strengthens, but do not accept, for the reasons set out in paragraph 4, that higher cost producers will be in a position to determine the behaviour of the shipbuilding market throughout the 1990's.

SECRET

BRITISH SHIPBUILDERS OPTIONSOptions and Costings

1. We agree with BS that the main options they have identified are those before the Corporation. Details, with costings, are as follows:

Option 1 would mean the closure of North East Shipbuilders and Govan, as their workload runs out by 1990. Appledore Ferguson, which builds small ships, the engine builder Clark Kincaid and the small service companies, Sunderland Forge and Marine Design Consultants, would be closed or sold. There would be up to 6300 redundancies, mainly in Scotland and the North East. The cost to BS over four years would be £365m and the exchequer cost of redundancies, which includes dependent suppliers, could be between £70m and £120m, making a total exchequer cost of around £450m in all. Exchequer costs of redundancies have been estimated on the basis of three and five year reabsorbtion profiles, and on the assumptions that one job would be lost in supplying industries for every job lost in BS, and that half the dependent redundancies were outside the Assisted Areas. The estimates do not allow for macroeconomic adjustment at the national level.

Option 2 would close Govan and build up NESL. Appledore and Ferguson and Clark Kincaid would be closed or sold, but the Sunderland Service Companies would be kept. Employment after four years would have dropped slightly to 5660. Option 2 would cost BS a total of £397m over four years, of which £90m would be for restructuring. The exchequer cost of redundancies could be between £13m and £22m giving a total Exchequer of the order of £415m. Substantial further costs arising from BS continuing need for subsidy would have to be met in the 1990's. These could range between £300m and £700m for the decade as a whole, depending on the market.

Option 3 would combine Govan and NESL under one management, and maintain all other facilities with a view to their eventual privatisation. The cost to BS would be some £340m. Redundancies would be negligible. The position in the 1990's is under Option 2. On the same assumptions, the cost per employee would be between £5,000 and £10,000 per year.

Option 4 would close one large yard. BS assume this would be Govan since NESL has the more flexible facilities. Closure of Govan and Clark Kincaid would cause 2600 redundancies mainly on the Clyde. Operations would centre on NESL broadly at its present size. The cost to BS over four years would be £376m, of which £100m would be for restructuring. The exchequer cost of the redundancies would be between £30m and £50m giving a total exchequer cost of around £415m.

Over the 1990's cost per employee would be similar to those described under Option 2. Total costs could be in the range £150m-£350m. Whichever Option were followed, BS is likely to receive £70m of privatisation and other receipt during the 1990's.

Table B1 sets out BS detailed costing of Options 1 to Table 4 over the four years shown in the Corporation's Strategy Paper. In Option 1, BS have assumed bonuses of £20m will be required to cushion disruption, but they have also assumed £25m of additional costs both at Govan and at NESL in connection with "last ships", the final China ship and the last six Danish Ferries. These sums are equivalent to the last China ship and the last six ferries not being completed, and being scrapped. In practice, it might prove possible for BS to encourage its workforce and management to stay the course and finish the ships, or for ships to be completed elsewhere. It is difficult to judge the sums that would be necessary to achieve this. In all likelihood, given the £20m of closure bonuses already assumed, they would be within the figures BS have proposed.

3. In their preferred Option 3, BS have assumed a realistic improvements of 6 percent in productivity and a reduction in overhead costs also of 6 percent on recent levels. The cash projection for 1990/91 also reflects an improvement in prices of 16 percent over 1986 levels. These assumptions still produce a cash cost per employee of the order of £10,000 per man year by 1990/91.

## Sixth Directive

Article 5 of the Sixth Directive on Aid to Shipbuilding limits the total amount of State Aid a shipbuilder can receive over the course of a year. In the Directive, the limit is expressed as a percentage of turnover net of certain excluded costs including the costs of any restructuring. The percentage ceiling is the same as that applying to aid for individual orders, 28 percent of cost in 1987. This is subject to annual revision, depending on movements in the gap between Far East prices and European costs. The Commission has yet to define precisely what will be included under turnover or how such items as Development Aided costs will be assessed in applying Article 5. This is unlikely to become clear before Commission Officials have had the chance to examine returns from each Member State early in 1988.

At this stage, we are therefore not in a position to judge precisely how Article 5 will be applied, or what scope there might be for flexibility on the part of the Commission or creativity on ours. What is clear, however, is that Option 1 should not present any difficulty, since the Commission's main objective is to encourage restructuring.

Option 3, however, anticipates funding requirements year by year that are likely to be very considerably in excess of Article 5 limits unless BS were allowed to finance a substantial part of its operations from borrowing of a kind the Commission was prepared to accept was not State Aid. But even if BS were allowed to borrow to cover those of its costs year by year

beyond Community limits, and the Commission was prepared to accommodate favourable treatment of certain BS costs, which we cannot rely on, we estimate it would be several years before borrowing was repaid. Without an accommodation, there is no unwinding in sight. Indeed, if the market does improve, the difficulty would increase, since the Directive has the effect of reducing the amount of public funds that can be paid faster than BS costs reduce. In this case, unless the Commission were prepared to adopt a different approach because a number of Member States were in the same difficulty, an individual accommodation with the Commission would become unavoidable unless we were to adopt a radical solution, for instance combining BS with a profitable public sector body so that State Aid was not involved in its financing. While such a move might technically comply with the Directive, it would certainly be against its spirit.



TABLE B1

COST OF OPTIONS

<u>Option 1</u>	<u>£m</u>				<u>TOTAL</u>
	<u>1987/88</u>	<u>1988/89</u>	<u>1989/90</u>	<u>1990/91</u>	
Cash	123	91	132	19	365
Cash net of restructuring	112	62	34	10	218
Trading Loss	69	108	51	10	
Contract Support	37	-	-	-	37
Employment	6313	4602	1883	170	
Cash/Employee (£K)	18	13	18	6	
(a)					
<hr/>					
<u>Option 2</u>					
Cash	123	97	124	53	397
Cash net of restructuring	115	72	68	52	307
Trading Loss	n.a.	n.a.	n.a.	n.a.	
Contract Support	55	44	42	27	168
Employment	6313	5782	5077	5660	
Cash/Employee (£K)	18	12	13	9	
(a)					
<hr/>					
<u>Option 3</u>					
Cash	117	80	70	70	337
Cash net of restructuring	117	80	67	70	334
Trading Loss	62	42	35	34	
Contract Support	83	43	31	20	177
Employment	6313	6559	6270	6280	
Cash/Employee (£K)	19	12	11	11	
(a)					
<hr/>					
<u>Option 4</u>					
Cash	123	94	114	45	376
Cash net of restructuring	118	66	56	35	275
Trading Loss	n.a.	n.a.	n.a.	n.a.	
Contract Support	70	31	25	4	130
Employment	6313	5676	4556	3740	
Cash/Employee (£K)	19	12	12	9	
(a)					

(a) nett of restructuring

**SECRET****SHIPBUILDING REDUNDANCIES**

... The attached Table C1 shows how the redundancies involved in a full closure programme - option 1 - would be spread among the Travel-to-Work-Area in which BS facilities are located, each year over the closure period. Table C1 also shows the impact which these redundancies would make on the unemployment rates in the various TTWA's. Appledore's unemployment rate would go up from 16 percent to over 21 percent, and Sunderland's from 19 percent to 20 percent; other effects are relatively minor. The figures in Table C1 assume that around 200 jobs at each of Clark Kincaid and Sunderland Forge might be saved in a sale of these facilities, as might 100 jobs at Marine Design Consultants. There are also 90 NESL workers engaged on an oil refinery maintenance contract, and nearly 200 HQ and support staff who do not appear in the tables. The profile at Govan assumes only 2 China ships are built. If the Chinese take up their option for a third, the redundancies are pushed back by six months.

2. Table C2 shows the redundancies which could happen in the private sector merchant yards, were subsidy for these yards to be phased out entirely in line with a withdrawal of merchant support from British Shipbuilders and Harland and Wolff. Total redundancies in the private merchant sector could amount to

around 550. A proportion, perhaps substantial, of these jobs might anyway be lost over the next two years if we reduce Intervention Fund limits to recover the PES baseline. The rest would go around the return of the decade if support were entirely withdrawn.

3. Table C3 gives similar information for the warshipbuilding yards, including Scott Lithgow, where substantial redundancies are also in prospect. These could amount to around 3,500 in total by the end of next year.

4. As a result, total shipbuilding redundancies in England and Scotland in the next few years could amount to some 10,000, added to which could be 4000 redundancies in Northern Ireland if Harland and Wolff were to close. This total of 14,000 potential redundancies amounts to some 38 percent of the current shipbuilding workforce (of 37,000) - which BS fear could result in severe industrial unrest in the sector.

5. On top of these redundancies is the possibility of heavy redundancies in supplier companies. The Department's economists have estimated that, for every shipbuilding job lost, a further job will also be lost to supplying industries. BS contend that the multiplier for job losses in the suppliers could be even higher at 2 to 1, but they have not substantiated this view.

## BS REDUNDANCIES

TABLE C1

Travel to Work Area	Unemployment rate (Sept 1987)	Yard	1988		1989		1990		TOTAL		
			No	Effect on Unemployment Rate	No	Effect on Unemployment Rate	No	Effect on Unemployment Rate	No	Effect on Unemployment Rate	
Sunderland	19.4%	NESL	400 <sup>a</sup>		1700 <sup>b</sup>		400 <sup>a</sup>				
		SFS	110		100						
		MDC	50								
			<u>560</u>	+0.3%	<u>1800</u>	1.0%	<u>400</u>	0.2%	<u>2760</u>	1.	
Glasgow	16.9%	Govan	<u>600<sup>a</sup></u>	+0.1%	1170 <sup>b</sup>	0.2%	-	-	<u>1770</u>	0.	
Bideford	15.7%	Appledore	<u>538<sup>c</sup></u>	5.7%	-	-	-	-	<u>538</u>	5.	
Greenock	19.3%	Ferguson	200 <sup>d</sup>		115 <sup>d</sup>				315		
		Clark	291 <sup>e</sup>						291		
		Kincaid									
			<u>491</u>	<u>1.1%</u>					<u>606</u>	1.	
		TOTAL	2189		3085		400	TOTAL	5674		

Note

a end 1988

b steady rundown through year

c 200 at beginning of 1988; rest steadily through year

d early in year

e from mid until end 1988

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TABLE C

REDUNDANCIES FROM UK PRIVATE SECTOR MERCHANT YARDS

YARD	Current employment	Possible Redundancies	TTWA	Current Employment Rate	Effect of Shipbuilding Job Losses
McTay Marine Ltd	90	90	Wirral & Chester	17.7%	-
Cochrane Shipbuilders Ltd	350	175	Goole & Selby	12.7%	+0.6%
Richard Dunston (Hessle) Ltd	150	150	Hull	14.5%	+0.1%
Richards Shipbuilders Ltd	165	35	Lowestoft	13.0	+0.1%
	95	95	Great Yarmouth	13.3	+0.2%

CONFIDENTIAL

TABLE 02

POSSIBLE REDUNDANCIES FROM UK WARSHIPBUILDING YARDS

YARD	Current Unemployment	Possible Redundancies	Travel to Work Area	Current Unemployment Rate	Effect of Shipbuilding Job Losses	Note
Swan Hunter	3850	260 (announced)	Newcastle South Tyneside	15.6% 23.0%	- +0.2%	
Yarrow	4100	Up to 1700 (not announced)	Glasgow	17.3%	+0.3%	See also BS table on Govt
Scott Lithgow	1500	1500 (not announced)	Greenock	20.3%	+3.2%	See also BS table on Ferguson and Clark Kincaid

WARSHIPBUILDING

(Note by the Ministry of Defence)

1. The Secretary of State for Defence gave a fuller survey of the prospects for warshipbuilding in his paper for E(A) Committee in September(1).

2. In summary, the industry can be seen in three parts:

- a. The Barrow yard <sup>of</sup> /Vickers Shipbuilding and Engineering Ltd (VSEL), employing some 9,000, will be fully loaded with submarine work until the mid 1990s. The third Vanguard class SSBN is currently scheduled to be ordered in 1988, and there are sales opportunities in Canada and Saudi Arabia.
- b. Vosper Thornycroft (South Coast) and Cammell Laird (Merseyside) have won batch orders for minehunters and conventional submarines which will provide stability until the early 1990s, albeit with a <sup>further</sup> gradual reduction in their workforces (currently 4,000 in aggregate)
- c. Scott Lithgow (Clyde), Swan Hunter (Tyne), Yarrow's (Clyde) and Harland and Wolff (Belfast) face a marked decline. The only major orders in prospect are 1 AOR and up to 4 frigates (the latter depending on defence programme decisions). Overall employment of some 10,000 on Defence work is expected to decline to 7,000/ <sup>over the next year or so.</sup> Sales prospects (eg in Pakistan) are uncertain). Further redundancies are inevitable and there will be a continuing risk of closures as work runs out.

3. The position on the AOR negotiations with Swan Hunter is set out in the letter from the Defence Secretary at Appendix 1; a revised bid was due on 6 November.

4. Tenders for the frigates were sought from Yarrows, Swan Hunter, Cammell Laird and Vosper Thornycroft last month; and decisions on orders are scheduled for next Summer. The MOD would expect to award a batch order to the most competitive yard.





TO:

PRIME MINISTER

FROM:

KENNETH CLARKE

13 November 1987

*put with pps  
for mtg  
18/11*

CH/EXCHEQUER	
REC.	13 NOV 1987
ACTION	D/L Moore
COPIES TO	FST CST Sir P Middleton Mr Monck - Mr Burgner Mr Colman Mr A M White Ms Secummen

**FRIGATE ORDERS**

1 Further to my minute to you of 9 November on shipbuilding, I attach a note prepared by my officials (who have consulted Ministry of Defence officials) about the costs and consequences of bringing forward two frigate orders in addition to the four for which tenders are currently being sought. I do not recommend advancing orders in this way as a route out of our other problems but I pass this on as a factual analysis and useful background.

2 There would be considerable extra costs to the Defence budget in the PES period (and later), though there could be substantial savings from 1992/3 and beyond. I understand that George Younger's view is that he has no money to advance orders in this way and that there is no defence reason for doing so.



3 The essential judgement is whether the additional cost that would result from bringing the order forward would justify avoiding the loss of some 2,500 jobs in the successful yards for about 4 years. It seems to me an expensive way of achieving a limited objective - I have other proposals of my own for spending money to create new types of employment in areas adversely affected by the condition of merchant shipbuilding.

4 There is also the question of where any extra frigate orders might be placed. At present, MOD is seeking tenders by January 1988 for four frigates. If MOD were to run a competition for all six frigates it seems quite likely that the natural outcome would be for the order to be shared between Yarrow and Swan Hunter, both of which have the capacity to build four and both of whom urgently require new work. But the possibility of Cammell Laird or Vosper Thornycroft making a competitive bid for one or more cannot be ruled out even though their requirement is less.

5 If colleagues do decide to bring forward these orders, I would be opposed to the allocation of the orders to particular yards in advance of a tender competition. It might be possible, however, for MOD to invite tenders for two extra frigates and to decide whether these should be placed (and where) in the light



of the outcome of the current competition. We would need to consider too whether it would be possible for MOD to bring forward the announcement of the outcome of the competition to coincide with an announcement of other decisions on shipbuilding.

6 I am copying this minute to Willie Whitelaw, Nigel Lawson, George Younger, David Young and Sir Robert Armstrong.

Julian Farrel

PP KENNETH CLARKE

(Approved by the Chancellor  
and signed in his absence)



## FRIGATE ORDERS

Note by the Department of Trade & Industry

1. At present, MOD is seeking tenders for up to four Type 23 frigates from Yarrow (Glasgow), Swan Hunter (Tyneside), Cammell Laird (Merseyside) and Vosper Thornycroft (Southampton). The actual number and timing of the order (as well as the distribution between yards) will depend on the outcome of the tender and of MOD's financial position at the time. Their most optimistic assessment is that they will be able to place 4 orders in June 88 with construction starting in November 88, June 89, November 89 and May 90. The estimated cost of these orders would be about £500m and MOD are reviewing whether they can afford this.

2. It would be feasible to add 2 extra frigates to the programme if the necessary finance was available from outside the Defence Budget to begin construction in December 88 and June 89. The extra cost (assuming the extra frigates represent early ordering rather than adding to overall total) would be:

£m (Current prices)

88/9	89/90	90/91	91/92	92/93	93/94	94/95	95/96	96/97	Later
+17	+34	+51	+67	+32	-11	-32	-55	-41	-62

To achieve this programme, orders for long-lead items would need to begin in December 87. These could be used by any yard.

3. The consequences will depend on where the extra orders are placed. It is possible that one yard (either Swan Hunter or Yarrow) could win all 4 of the frigates currently on offer since both those yards have ample spare capacity. Alternatively, the order could be split between these two and/or Cammell Laird and Vosper Thornycroft. However, if either Swan Hunter or Yarrow were to win none of the orders the effect on that yard would be severe.

4. Cammell Laird and Vosper Thornycroft also have spare capacity. Cammell Laird can keep its current workforce reasonably employed on submarines until the early 90s. Vosper Thornycroft's frigate building capacity is idle.

5. The effect on jobs of bringing forward 2 orders would be to avoid the loss of about 2,500 jobs in the successful yards for a period of about 4 years. This combined order (6 ships) would be beyond the current capacity of any one yard. It is likely that the competition would lead naturally to the work being shared between 2 yards.

11 November 1987

99930-80



388

PRIME MINISTER

SHIPBUILDING

CH/EXCHEQUER	
REC.	17 NOV 1987 ✓ 17/11
ACTION	MR D. MOURE
COMES TO	C ST FBT SIR P. MIDDLETON MR ANSON MR MONCK MR BURGNER MR ROBSON MR COLMAN MR AWHITE MS SEAMEN MR CALL

I have now seen Kenneth Clarke's minute to you of 9 November which covered his note on the prospects for British Shipbuilders which we are to discuss on Thursday. In his letter Kenneth refers to measures which might be taken to mitigate the problems which a rundown of BS might cause in the North East of England and refers to the likelihood that Malcolm Rifkind might wish to consider whether something of the same order will be appropriate in Scotland.

As you can imagine I will face similar problems in Northern Ireland from any decision to close H&W and, indeed, the difficulties will be greater. Not only will I be faced with the need to replace jobs in an area which already suffers from a very high level of unemployment (and I appreciate that this is a problem shared by other parts of the United Kingdom) but I will also have very major problems associated with political developments in Northern Ireland. These problems are compounded by current difficulties facing other major engineering companies in Belfast.

As I noted in my submission for discussion on 19 November we will clearly have to take vigorous action to promote new jobs and my officials are already developing proposals. Necessarily this has had to be on a very confidential basis and I am not able at this stage to advance firm indications of the likely cost of the measures which will be needed. The nature of the measures would be similar to those proposed for Sunderland and Govan but the



scale of the H&W redundancy would be significantly larger than at either of the other two yards individually and the costs are likely to reflect this. As noted in my paper I will be coming forward to the Chief Secretary in due course with more detailed proposals and these could involve a bid on the Reserve.

I am copying this note to Willie Whitelaw, Nigel Lawson, George Younger, David Young, Kenneth Clarke, Malcolm Rifkind and Sir Robert Armstrong.

*Robin Rosefield*

*for* T.K.  
(Approved by the Secretary of State  
and signed in his absence in  
Northern Ireland)

17 November 1987

SECRET



Prime Minister

CH/EXCHEQUER	
REC.	18 NOV 1987
ACTION	Mr DJR Moore
COPIES TO	FST LBT
	SE P Middleton
	Mr Monck
	Mr Suggner
	Mr Cobman
	Mr A M White
	Ms Sedman

**SHIPBUILDING**

I would like to comment briefly on the proposals made in Kenneth Clarke's minute of 9 November which we are to discuss on Thursday 19 November.

I agree with much of Kenneth's analysis. In particular, I agree that if a yard runs out of work and has no prospect of any new work, there is no responsible alternative to closure. That seems likely to be the position facing Scott Lithgow.

However, the recommendation appears to be that we should announce now that the British Shipbuilders yards will close in 1989 or 1990 irrespective of their prospects of winning further orders and of the actual state of the shipbuilding market at that time. This seems a highly expensive course of action and one fraught with political difficulties.

I would draw attention to the following particular considerations:

(a) Closure (under option 1 of those identified by British Shipbuilders) would cost some £450 million to which would be added, under the Chancellor of the Duchy's proposals, £96 million for recovery and employment measures in the North East and a likely comparable sum on the Clyde. This would mean a total cost of around £650 million compared to £350 million (plus any continuing subsidies) under option 3.

(b) British Shipbuilders believe the demand for ships is likely to improve and that there could be significant orders available from 1990 onwards.

SECRET

**SECRET**

(c) To announce ultimate closure now and to forbid the yards even to look for and accept new orders would be considered perverse and unreasonable. The public outcry would be intense if, for example, Govan were forbidden from accepting the order for the third Chinese ferry.

(d) The employment consequences are pretty appalling. The closure of the British Shipbuilders yards would result in the loss of 6,500 jobs in shipbuilding and a total of 13,000 altogether. These are almost entirely in areas of very high unemployment where alternative jobs will be difficult to achieve even with massive new resources. It would thus be essential to be able to demonstrate that no new shipbuilding work is available before closure was announced.

(e) We should not underestimate the political gift to the Opposition of announcing that in three years' time the yards will be closed regardless of potential orders. Major unrest with strong political backing would seem very likely and would continue with mounting intensity during that whole period.

It would seem far preferable to allow the yards to seek further orders under strict criteria but to make it clear that if they fail to win any, closure would then be inevitable. In the meantime, if we were to initiate preliminary work on the Chancellor of the Duchy's imaginative proposals for alternative employment in these areas, this would demonstrate the Government's responsible and sensitive approach.

I am copying this minute to Kenneth Clarke, Willie Whitelaw, Nigel Lawson, David Young, Tom King and Sir Robert Armstrong.

MR

MR

17 November 1987

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HMP32108



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FROM: W HOOD

DATE: 17 November 1987

1. MR D J L MOORE *DW 17/11.*  
 2. CHANCELLOR

cc Chief Secretary  
 Financial Secretary  
 Sir P Middleton  
 Mr Anson  
 Mr Monck  
 Mr Burgner  
 Mr Robson  
 Mr Colman  
 Mr A White  
 Ms Seammen  
 Mr Call

**SHIPBUILDING**

This submission forms the briefing for the Prime Minister's meeting on Thursday 19 November. The meeting is likely to consider a number of related decisions concerning the future of the shipbuilding industry, but these can conveniently be considered under the following general headings:

- a. the future of British Shipbuilders *(see para 2.7 for recommendations)*
- b. the nature of any employment measures associated with a decision to close BS as recommended by Mr Clarke *(para. 12).*
- c. frigate orders *(para. 13)*,
- d. the future of Harland and Wolff

This brief covers a., b. and c., with contributions from IAE2 and DM1 as appropriate. ST3 are submitting separately on d.

**BRITISH SHIPBUILDERS**

2. Mr Clarke's minute to the Prime Minister of 9 November concludes that BS should be closed down over the next two years as existing orders run out. Briefing on the substance of Mr

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Clarke's proposals for BS was included in Mr Colman's submission of 23 October, and as before, we recommend you to support strongly the conclusion that BS should close.

3. We understand that Mr Rifkind agrees that options 2 and 4 can be ruled out, but wishes to ensure that Option 3 should be considered very thoroughly. If it is the wish of his colleagues to go for Option 1, however he would wish to ensure that a suitable employment <sup>package</sup> was in place. We think that this means that Mr Rifkind will not fight as vigorously against Mr Clarke on shipbuilding as he did on steel.

4. The arguments for closure are:

- there is no prospect of BS ever becoming commercially viable on a long-term basis. Annex A to Mr Clarke's minute puts forward the case that there is a reasonable prospect of market balance by the 1990s. We are sceptical both of this possibility and of the associated possibility that BS's external financing requirement might fall to zero at that time. (It remained at well above £100 million per year over the last cyclical peak in 1980 and 1981). Nevertheless, even if such a combination of circumstances were to come about, it would last for only perhaps 2-3 years, after which BS would need substantial support again. There is no reason to believe that shipbuilding will not remain vulnerable to long periods of excess capacity.
- as last year's report by officials (MISC 127) concluded, there is no strategic case for maintaining an uncommercial merchant shipbuilding industry.
- Option 3, ie keeping BS going at its current level of activity, would cost £300-700 million during the 1990s, although closure <sup>(option 1)</sup> might cost around £100 million more

up to 1990-91 (paragraph 1 of Annex B).

- Option 3 anticipates funding requirements which go well beyond existing or prospective EC limits. It is likely that an individual accommodation with the Commission will be necessary.

5. We do not think that the decision should turn on the costings in Annex B to Mr Clarke's minute because the key point on cost is the potential long term support of £300-700m referred to above. In case there is any discussion of them, however, you should be aware that the Exchequer costings in Annex B to Mr Clarke's minute will require some revision in due course and are intended only as broad orders of magnitude. In particular, the apparent inconsistency, referred to in Mr Colman's submission of 26 October, whereby Option 1 assumes the completion of 2 Chinese ships while Option 3 is based on 3 Chinese ships, has not been resolved. In fact, the finance agreement for the first two ships has now been signed and they are fully contracted. The opportunity to sign the finance agreement for the third container ship has been extended to 31 December 1987, when the option to order it also expires. It is expected that the Chinese will exercise the option. The costings also take no account of possible longer-term Exchequer savings from the rundown in the apparatus of support for shipbuilding outside BS's EFL. This includes Intervention Fund support for private sector shipbuilders, and subsidy given to BS and private sector merchant shipbuilders through export credit subsidy and the Home Shipbuilding Credit Guarantee Scheme. Mr Clarke has made no specific proposals for the schemes as they apply to the private sector nor any estimate of savings, although there will certainly be some. Thirdly, paragraphs 1 and 5 of Annex B states that the costings have been estimated on the basis that one job would be lost in supplying industries for each job lost in BS. This is not the case. The assumptions, agreed between DTI and Treasury officials, are that each job in shipbuilding is associated with one in supplying industries and that half the jobs lost to

SECRET

shipbuilding related work in supplying industries are reabsorbed elsewhere. Thus, overall only half the number of jobs lost in BS is assumed lost in supplying industries.

Timing of Closure

6. There is no economic case for keeping BS going longer than necessary. Now that contracts have been signed for the first two Chinese ships, it would be very costly to withdraw as well as politically very embarrassing. The two Chinese ships will keep Govan in work until September 1989 on BS's current estimates. However, DTI Ministers have made out no case for:

- (a) continuing to build 25 small ferries which will keep NESL at Sunderland in work until 1989;
- (b) accepting the likely order for a third Chinese container ship, which would extend Govan's life for a further 6 months into the spring of 1990;
- (c) accepting further orders for ships to be built at Appledore and Greenock. We understand that letters of intent are about to be signed for a dredger to be built at Appledore, and there are three further possible orders for dredgers and ferries which may be signed over the next three months.

All of this work is likely to be heavily loss-making, and although withdrawing from the Danish ferries and the third Chinese ship will entail cancellation costs, we have seen no assessment of the balance of advantage in these cases. There are of course no cancellation costs under (c) as no contracts have been signed.

7. We therefore recommend you to oppose the "soft-landing" approach other than for the first two Chinese ships at Govan. The balance of advantage remains firmly in favour of early closure

at the smaller yards, and the case for continuing to keep NSEL open has not been made out.

#### Timing of the announcement

8. There is now some doubt about the need for an announcement on steel before 8 December. We still think that the decision on Shipbuilding risks being undermined unless it is announced at the earliest possible moment. It is important to avoid the possibility of two announcements, one on steel and one on shipbuilding, each requiring an employment package. If there is to be a package, we do not want more than one.

#### POSSIBLE MEASURES TO RELIEVE THE EFFECTS OF REDUNDANCIES

##### Departmental proposals for special measures

9. The report from the Official Group on Measures to Alleviate the Effects on Redundancies recommends that if Ministers decide to adopt option 1 in the British Shipbuilders Corporate Plan involving redundancies of 6,246 workers in Sunderland, Glasgow, Greenock and Bideford in 1988-90 they should consider a package of measures to alleviate the effects.

(i) It recommends a basic package involving;

- extending the life of British Shipbuilders Enterprise Limited or creating a successor body with enough funding to provide counselling, training and re-employment services and some promotion of new enterprises (estimated £12m over 3 years).
- Departments to consider how far the range of agencies and measures already available can be retargetted and better co-ordinated (in the North East such bodies include the Tyne and Wear UDC, English Estates North, the Sunderland Economic Regeneration Team as well as smaller bodies).

SECRET

- (ii) It suggests that if Ministers wish to go beyond this, various forms of enhanced package might be possible including additional enterprise promotion, perhaps drawing together the work of British Shipbuilders Enterprise Limited (BSEL) and British Steel Corporation Industries (BSCI) in the North East and additional resources for the Scottish Development Agency (SDA) in Scotland, additional provision for advanced factories (£10-£13m for English Estates in the North East and "several £m" for the SDA in Scotland) and new Enterprise Zones in Sunderland and Greenock.

10. DTI Ministers additionally recommend (Kenneth Clarke's minute to the Prime Minister of 9 November):

- A major new enterprise company, combining BSCI and BSEL (for the North East), with the suggestion that the Scots may want one too. The company would have a prominent industrialist as its head, be the focal point for industrial regeneration for the areas concerned, combine the activities of BSCI and BSEL and develop large industrial parks with a substantial promotional budget. (Preliminary costings are in excess of £200m over the three years, including £60m for provision of an additional 2m square foot of advanced factory build in the North East and perhaps £100m for nearly 4m square foot of additional advanced factory space in Scotland. These figures may be compared with total capital spend this year of £57m on advance factory building in England by English Estates, and capital spend of around £33m in Scotland by the SDA.)

11. No recommendation is made on the source of funding for any of these suggestions, but (at the Treasury's instigation) the report asks that Departments should consider with Treasury to what extent necessary funds can be provided from within their agreed PES provisions.

## SECRET

12. Mr King has indicated that he wishes to introduce measures in Northern Ireland along the lines proposed by Kenneth Clarke for England in response to redundancies at Harland & Wolff.

Recommended Treasury Position(a) Timing

Final decisions on scale and nature of assistance premature until:

- It is clear whether there will be a combination of shipbuilding and steel closures against which the adequacy of any measures will need to be defended. (It now seems possible that Ministers will decide to leave decisions on further steel closure to BSC post-privatisation, in which case the need for any package should be considered against the shipbuilding closures alone).
- Decisions have been taken on a possible new Enterprise Zone at Greenock (Inverclyde) which would in itself be a substantial initiative for that area. (The Scottish Secretary is expected to write to colleagues with a supporting case for this proposal in the course of this week).

(b) Possible Packages

- Any new redundancies will come at a time when unemployment is falling rapidly; total local unemployment down from 20.8% to 19.4% in Sunderland, 18.0% to 16.9% in Glasgow, 21.2% to 19.3% in Greenock, and 17.3% to 15.7% in Bideford. Even assuming option (i) and all those made redundant registered as unemployed the rate would be below the levels of June 1986 in Glasgow and would broadly return to the levels of June 1986 in Sunderland and Greenock.

SECRET

- Can accept a package of basic measures designed to combine best uses of existing programmes with continuation of counselling, training and enterprise promotion of kind currently undertaken by BSEL, funded from within existing departmental provisions.
  
- Not convinced that a case has been made out for the suggested elements of enhancement. If colleagues wish to pursue, officials should do further work on the costs and impact of more enterprise promotion or advance factory building activity, including examining how far these could be funded from within existing provision. The Scottish Secretary is still considering the case for an Enterprise Zone for Greenock. I would accept this with considerable reluctance, but if one were agreed it would substantially reduce the need for/scale of other measures in Scotland.
  
- The package proposed by DTI Ministers seems totally disproportionate to previous measures and the scale of the problem. Experience does not suggest that enterprise companies can spend large sums quickly or effectively. Particularly doubtful about suggested provision of "large industrial parks". What is the evidence that major shortage of industrial premises is causing a constraint on development? A new enterprise company may increase the problems of co-ordination (with SDA in Scotland and English Estates in England) rather than help to solve these.



FRIGATE ORDERS

13. Mr Clarke's minute says

"I do not recommend advancing orders [for two frigates] in this way as a route out of our other problems....it seems to me an expensive way of achieving a limited objective."

You should support this line. The cost is £169 million through 1991-92. Since the defence budget has no money, the cost would fall on the Reserve.

You should also resist any attempt to firm up the four frigates for which MOD invited tenders this summer. Probably only two can be afforded within the defence budget control totals. No decisions need to be taken until next year following the outcome of the competition, when the resource position will be clearer.

W. Hood

FRIGATE ORDERS

Over the Survey years, in spite of this year's additions of £1.3 billion, there is still a gap between defence programme and resources of some £1.5 billion. This gap has to be addressed in LTC 88. Some ship orders currently in the LTC 87 programme may have to be deleted. It follows that there is no money available for ship orders additional to those in the LTC 87 programme. The cost of any such orders would inevitably fall on the Reserve. Even validating the present LTC 87 order programme would reduce MOD's room for manoeuvre and hence add directly to their bids in next year's Survey.

MOD are currently out to tender for up to four frigates; they expect bids by January 1988 and a decision by June 1988. Of these four, only two can be expected to find a definite place in the core LTC 88 programme (ie that constrained to 1987 Survey resources). Swan Hunter and Yarrow are the two main contenders.

Usually, batch ordering provides substantial savings over splitting orders. Interference with the results of competition is a departure from policy, and creates moral obligations to the shipyard which, having won a competition, sees the fruits of its victory removed. Thus a sequence of robbing Peter to pay Paul is perpetuated.

The MOD have provided to DTI the following figures for two extra frigates (that is, six in all); we have added to them our figures for the cost of the two which will not, in all probability, find a place in LTC 88 core programme.

	£m			
	1988-89	1989-90	1990-91	1991-92
2 extra	17	34	51	67
2 dubious	0	1	16	24
Total	17	35	67	91

The total is the measure of the risk to public expenditure we face from possible decisions now.

The line should be to resist any new decisions now. MOD have already invited tenders for four frigates; to add another two now would not have a significant impact, except that it might look like a panic measure and therefore be counterproductive. Their costs would inevitably fall on the Reserve. Nor is there any need now to validate the current tender of up to four; whether all four can in fact be afforded will depend on the outcome of LTC 88 this winter.

Nor should we now decide a split between Swan Hunter and Yarrow. If Swan Hunter won, GEC would almost certainly keep Yarrow going (albeit with redundancies); it is the lead frigate yard. If Yarrow won, Swan's future might well be in doubt. But all this is hypothetical; wait for the results of competition.