E(79) 16th Meeting

COPY NO 57

CABINET

MINISTERIAL COMMITTEE ON ECONOMIC STRATEGY

MINUTES of a Meeting held
at 10 Downing Street on
WEDNESDAY 28 NOVEMBER 1979 at 12 Noon

PRESENT

The Rt Hon Margaret Thatcher MP
Prime Minister

The Rt Hon William Whitelaw MP
Secretary of State for the Home Department

The Rt Hon Sir Geoffrey Howe QC MP
Chancellor of the Exchequer

The Rt Hon Sir Keith Joseph MP
Secretary of State for Industry

The Rt Hon Lord Soames
Lord President of the Council

The Rt Hon James Prior MP
Secretary of State for Employment

The Rt Hon Peter Walker MP
Minister of Agriculture, Fisheries and Food

The Rt Hon Michael Heseltine MP
Secretary of State for the Environment

The Rt Hon John Biffen MP
Chief Secretary Treasury

THE FOLLOWING WERE ALSO PRESENT

The Rt Hon Francis Pym MP
Secretary of State for Defence

The Rt Hon George Younger MP
Secretary of State for Scotland

The Rt Hon Humphrey Atkins MP
Secretary of State for Northern Ireland

The Rt Hon Norman Fowler MP
Minister of Transport

The Rt Hon Nicholas Ridley MP
Minister of State, Foreign and Commonwealth Office

Mr Norman Tebbitt MP
Parliamentary Under-Secretary of State, Department of Trade

Sir Kenneth Berrill
Central Policy Review Staff

SECRETARIAT

Sir Robert Armstrong
Mr P Le Cheminant
Mr R G Courtney

SUBJECT

GOVAN SHIPBUILDERS

CONFIDENTIAL

GOVAN SHIPBUILDERS

Previous reference: E(79) 15th Meeting, Item 3)

The Committee considered a note by officials, circulated under cover of a letter, dated 27 November 1979 from the Private Secretary to the Secretary to the Cabinet to the Private Secretary to the Prime Minister, on potential public sector shipbuilding orders which might be placed with Govan Shipbuilders Limited.

THE PRIME MINISTER said that since the note had been prepared, there had been two developments. British Shipbuilders (BS) were reported to be confident that they could delay for a week the meeting with the Confederation of Shipbuilding Engineering Unions (CSEU) arranged for Monday 3 December; and, there was a new possibility of an order for 4 ships suitable for construction at Govan from the Silver Line.

THE SECRETARY OF STATE FOR INDUSTRY, said that although the note identified several orders which might possibly be placed with Govan, each presented its own difficulty. In any case, however, he thought it would be most unwise suddenly to produce a public sector order in this way. The Government would appear to be buying off the threat of union action over the run-down of the Fairfields yard. Either new public money would be involved, in which case the Government would have to defend spending it at Govan rather than elsewhere, or there would be a diversion of orders from other yards and consequent protests from local MPs and others. It would, he judged, be far preferable to proceed with the Liberty Maritime (LM) order. Negotiations for this had been in progress for some months and a letter of intent had been issued in July. This order would enable BS to carry through the planned run-down of the Fairfields yard without union problems. Thereafter no doubt, the yard would have to close - he doubted whether it would secure further orders - but the Government would have fulfilled its objective of separating in time the closure of the Scotstoun and Fairfields yards. Even if there was then industrial action, there was no penalty clause in the proposed LM order and any 'locking in' of the LM ships would not impose extra financial penalties to BS. The cost to public funds of the LM order would be just under £8 million. The figure of £21 million that had been discussed at the

Committee's previous meeting represented the total cost of building the two ships. This sum would only be lost if the ships, having been completed, were never sold. He did not regard this as a realistic possibility. The prospective order mentioned by the Prime Minister could not be placed quickly; designs would have to be agreed and there would be a need for negotiations with the European Commission over the terms of any public support. Moreover, he doubted whether the eventual terms of the order would be any better than those available from LM. In short, the LM order offered the best prospect for maintaining union co-operation, avoiding public criticism and avoiding the costly "locking-in" of the Polish ships at present under construction at Govan

In discussion the following points were made -

a. The industrial outlook for Clydeside was bleak but so far local opinion had responded well to the needs of the situation. A Government refusal to back the LM order could cause disproportionate local trouble in addition to the adverse consequences for British Shipbuilders and the public purse.

b. Although it was the case that the LM order derived from a company which would operate only one ship, the principal of the company, Mr Frangos, was a man of substance who already owned seven ships, was part owner of seventeen more and had a further eight building in Japan. The arrangement under which he operated his ships through a series of separate companies was common in the shipping industry and there was no evidence that Mr Frangos had ever defaulted on a deal.

c. The terms of the order were undoubtedly very favourable to Mr Frangos and in effect gave him a two-way option to be exercised in the light of future developments in the shipping market. But the state of the shipbuilding industry worldwide was such that many Governments offered exceptionally favourable terms to potential customers and the proposed arrangement with LM was not exceptional either in international, or national, terms.

d. Whatever justification for accepting the proposed terms might exist, it nevertheless remained the case that they represented, and would be represented as being, an exceptionally favourable deal for LM with the British Government putting up £8 million of assistance to a company with a paid-up capital of only £12,000 and one, moreover, which had not filed accounts since 1976 and was in consequence in breach of the Companies Acts. The criticisms which would be made would be very similar to those made by the Government, when in opposition, of the previous Government's subsidies on ship sales, particularly to Poland. It could also be expected that British shipping interests would object to Government subsidies to a competitor even though at least as good terms would be available to them for new orders.

e. If money was to be used to cushion the rundown of the Fairfield Yard it would be better spent on producing a vessel for which there was a clear United Kingdom need. The examination of the possibilities by officials pointed to fishery protection vessels, a tanker for the Royal Navy or rail ferries for British Rail was the best options. Unfortunately fishery protection vessels were too small to provide adequate employment at Govan and the other ships would cost far more than the £8 million available apart from other problems identified in the note by officials.

f. An alternative might be to use the money to provide enhanced redundancy payments for the men employed at Fairfield together with support for new industries which might be able to offer them employment. Significant improvements in redundancy terms could not however be confined to one shipyard and the overall cost of a concession could be very high. As to industrial development, the Scottish Development Agency already had adequate funds at its disposal.

g. If the concern was to ensure that the Polish ships were not "locked in" at considerable expense to the Exchequer, it might be better to use some of the available money to pay the Fairfield workforce to complete them on time. Such an arrangement would, however, have widespread repercussions in other spheres, eg on major construction sites, where the financial penalties to the owners of late construction were severe and who were consequently vulnerable to similar claims.

THE PRIME MINISTER, summing up the discussion, said that, although the Committee recognised the severe disadvantages of the course, they appeared on balance to prefer the LM order to the other options provided certain conditions could be met. These were that the full LM contribution of £0.5 million should be committed to the order and not just the £12,000 assets shown in the Company's accounts; that steps should be taken to ensure that LM complied with the requirements of the Companies Acts; that, if possible, a further financial contribution should be made by Hambros Bank; that it should be made plain to British Shipbuilders that the Government's contribution to financing the order was conditional on the work schedule for the ships being maintained; and that, in the event of the withdrawal of LM from the order after work on the ships had begun, any excess costs falling on the public purse over the proposed £7.9 million subsidy would have to be offset by reductions in the funds available to the Scottish Development Agency. The Secretary of State for Industry should explore urgently the financial conditions as they affected LM and Hambros and report the outcome to her.

The Committee -

1. Took note, with approval, of the Prime Minister's summing up of their discussion;

2. agreed that the Liberty Maritime order could proceed if the conditions outlined in the Prime Minister's summing up of the discussion could be met;

3. invited the Secretary of State for Industry to explore urgently the proposed financial conditions as they applied to Liberty Maritime and Hambros Bank and to report the outcome to the Prime Minister;

4. invited the Secretary of State for Trade to take steps to ensure that Liberty Maritime did not remain in default of its obligations under the Companies Act.

Cabinet Office

29 November 1979

CONFIDENTIAL

CABINET OFFICE

70 Whitehall, London SW1A 2AS Telephone 01-233 8319

From the Secretary of the Cabinet: Sir Robert Armstrong KCB CVO

Ref. A0778

27th November, 1979

Govan Shipbuilders Ltd.

Since Monday's meeting of E officials have investigated the possibilities of public sector orders for the Govan shipyard. I attach their report, which will be considered by E at its meeting after Cabinet tomorrow.

I am copying this letter to the Private Secretaries to members of E, the Secretaries of State for Defence, Scotland and Northern Ireland, the Lord Privy Seal and the Minister of Transport.

M. J. VILE

(M.J. Vile)
Private Secretary

T.P. Lankester, Esq.

AN ORDER FOR GOVAN SHIPBUILDERS

Note by Officials

1. We were asked, following the meeting of E Committee on 26 November, to review the possibility of finding a public sector order or order for the Fairfield Yard at Govan Shipbuilders in place of the two ships for Liberty Maritime. This note has been prepared by officials of the Departments of Industry, Transport and Energy, the Ministries of Defence and of Agriculture, the Scottish Economic Planning Department, the Treasury and the Central Policy Review Staff (CPRS), under Cabinet Office Chairmanship.

2. Govan Shipbuilders employ 5,450, of whom 1,100 are at Scotstoun and 4,350 at Fairfield. Scotstoun is due to close by the end of this year. The workforce at Fairfield is due to be reduced by 1,150 to 3,200, by voluntary redundancies and by transfers to other yards on the Clyde. This planned rundown has already started and will be completed on the delivery of the last Polish ship, now expected in March 1980. The achievement of this rundown is itself dependent on an assurance now of further orders for the yard after the completion of the Polish order. And the completion of the Polish ships will also be in jeopardy if further orders are not forthcoming. As of now, the yard has no further work beyond the Polish ships. The Liberty Maritime order would employ part of this workforce, utilising the whole only for a brief period in the summer of 1980 and finishing completely in the Spring of 1981.

The Need

3. Ideally, any new order should provide comparable employment to the Liberty Maritime order. It should not involve a ship for which there was an urgent operational requirement, because of the risk that it might be 'locked-in' if the plan goes wrong. The additional cost should be within the limits of finance which the Department of Industry were prepared to make available for the Liberty Maritime order (see below). It should be suitable for the modern facilities at Fairfield, which is a general-purpose yard concentrating on medium/large merchant ships. It has available a range of designs for bulk carriers and general cargo ships of around 25,000 tons. With more notice, it could construct any other relatively sophisticated merchant ship or fleet

auxiliary. Within the total numbers employed, it is particularly important to find work if possible for the 1,000 steelworkers at the yard, whose work comes first in the construction of any ship and is now diminishing. If the market recovers sufficiently (and there are some signs of recovery now), British Shipbuilders plan to secure orders for the yard for ships of higher added value such as ferries.

Available Finance

4. The proposed contribution from public funds (provided within the Department of Industry's and British Shipbuilders' PES allocation) for the Liberty Maritime deal was:

i. £4.5 million grant from the Intervention Fund, spread over two years;

ii. £0.7 million as an interest relief grant from British Shipbuilders (spread over the 15-year life of the ship);

iii. £2.7 million grant element as Section 10 assistance (spread over 8 years).

5. The total direct public support was therefore £7.9 million. The figure of £21 million mentioned in the CPRS paper (E(79) 66) is the total cost of constructing the vessels. This would be lost only if the ships were completed and then locked-in permanently, without being re-sold. Given the other calls on Department of Industry shipbuilding funds, we understand that there is little prospect of providing further public assistance, beyond the £7.9 million, from this source.

6. We have considered a full list of potential public sector shipbuilding orders over the next few years. Only 7 of these are remotely suitable for Govan, and there are serious problems in each case.

(i) Offshore Patrol Vessels (OPVs or Fishery Protection Vessels)
There is a requirement for 4 replacement vessels (at about £10 million each) for the Fisheries Departments and Ministry of Defence and for one smaller vessel at a cost of £5 million for the Department of Agriculture and Fisheries

for Scotland (DAFS). The Treasury has offered, in the context of the current Public Expenditure Survey discussions, to finance two of these. It would be possible to operate more than these two if the funds were available, but this would impose current costs as well as capital costs for which there is at present no provision. There is an established design for these ships, developed for Ministry of Defence by Hall Russell, a British Shipbuilders subsidiary in Aberdeen. The first two ships are being built in Aberdeen and the first will be launched in March. Any subsequent orders could be allocated to Fairfields but British Shipbuilders estimate that, because the facilities are less suitable, the shipbuilding cost could be 20/25 per cent higher than at Aberdeen, requiring still further extra funds. If all three extra ships were allocated, the work would occupy about 750 men at the peak.

ii. Fleet Support Tanker

Ministry of Defence is now in the final stages of tendering for two fleet support tankers though it is currently reconsidering whether it can afford them at the present time. The design work has been done. The two would cost £54 million. Each ship would employ 1,000-1,500 men. Govan is not one of the yards tendering for this order. There has been great political pressure for these orders and lobbying by local Members of Parliament especially on behalf of Swan Hunter, Cammell Laird and Harland and Wolff. Any departure from normal tendering would therefore be controversial and might involve higher costs. Work could begin by the middle of 1980. These would be suitable ships for construction at Govan, and a delay in their completion could be tolerated.

iii. Conversion of HMS Tarbatness

This is a potential major reconstruction job, but does not involve much new steelwork. Ministry of Defence have no present PES funds and may drop it from their programme. Work on design has now stopped. The contract price would be over £30 million, of which a high part would be fitting-out of new equipment. Further design work at Cammells would be necessary and a start could not be made for some months.

iv. Hydrographic Vessels

There is a requirement for three of these. They are small and complex vessels. The cost would be £24 million (for which PES provision has not yet finally been approved) for all three, and about 500 jobs per vessel would be involved. The detailed design work has still to be done, and no order seems possible before early 1981.

v. Train Ferry for British Rail (BR)

British Rail is considering ordering two new train ferries for the Harwich/Zeebrugge route at a cost of £13 million each. The viability of the operation depends on improved railway and Customs operations. The Government has not yet approved the order, for which there is no provision in BR's investment programme. There is pressure from Germany to improve the through rail freight service, and from Belgium for at least one of the orders. Some design work has already been done. British Shipbuilders, who have been involved, believe they could start in about six months. It is unlikely that British Rail would choose Govan.

vi. Cable Ship for Cable and Wireless

A decision in principle has been taken by Cable and Wireless to construct a new cable ship. But the design will not be finalised until the end of February, and there will be a tendering and negotiating process after that. Cable and Wireless believe they would not start until September 1980; the Department of Industry think it might be possible to start a month or two earlier. This will be a large job around £15 million or more. There will be political pressures to construct in the North East; Lord Glenamara is the Chairman of Cable and Wireless.

vii. A further Fleet Support Tanker for Ministry of Defence, to a basic commercial design with minimum modifications.

Provided extra funds could be made available, MOD could find a use for such a vessel which might cost up to £20 million and could be started quite quickly. This would avoid the need to divert existing orders from other yards but would involve additional running costs in due course. If MOD then decided to postpone the two specialist tanker vessels, there could be reactions at the other yards which might have expected the orders.

7. Further options

There are two other possibilities which could be considered:

viii. Speculative building

The Liberty Maritime order itself could be regarded as a form of speculative building, with the purchaser laying out only £0.5 million for an option which he could later decide to cancel, leaving British Shipbuilders with the vessels. A straight speculative build financed by the Government would lead to pressure for comparable orders from other yards.

ix. Diverting work from other Ministry of Defence dockyards

There is little or no scope for this in the short term because the facilities and labour force at Fairfield are not suited for warship construction and refit.

Cabinet Office

27 November 1979