PRIME MINISTER

TALBOT AND IRAN

On 15 April I was invited by OD to consider whether there were any possible ways of alleviating the effect which an export embargo would have on Talbot Cars. I attach my estimation of this effect and my views on the action which the Government could consider taking.

It is quite clear that the financial position of Talbot UK remains extremely fragile and any small set-back is liable to bring it down. If, therefore, sanctions against Iran were extended to current contracts as compared with new business, it is probable that Talbot's UK operations would face liquidation or receivership within a relatively short time. From this point of view and more generally, even though it would reduce the impact of our sanctions, I share Geoffrey Howe and John Nott's view that it would be in our best interests as a trading nation to honour existing contractual obligations to the Iranians at least at this stage. We can always reconsider our position if there is no move to free the US hostages after the Iranian Parliament has assembled. I certainly do not feel that we should take action on existing contracts unless all our partners and the Japanese were prepared to follow the same line. In the case of Talbot it would be particularly unfortunate if we put PSA Peugeot Citroen at a disadvantage while the French Government did nothing to prevent Renault from honouring existing contracts in Iran.

I am copying this minute to members of OD, to George Younger, because

/of ...

of the potential effect on employment in West Central Scotland of the worst consequences of an embargo on current contracts with Iran, and to Sir Robert Armstrong.

K J

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2 May 1980

POSSIBLE ASSISTANCE FOR TALBOT MOTORS LIMITED IN THE EVENT OF A TRADE EMBARGO ON IRAN

INTRODUCTION

1 On 15 April OD invited me:

> "To consider whether there were any possible ways of alleviating the effect which an export embargo would have on Talbot Cars".

This note outlines the probable effects, considers action which might be taken and makes recommendations. The figures used in this assessment are the Company's own estimates.

THE EFFECTS OF AN EMBARGO

2 The impact on Talbot will depend upon whether current contracts are excluded from the embargo and if not, the length of time it remains in force. If current contracts are excluded and ECGD cover can be retained, the embargo itself will have no effect on Talbot although, of course, the Iranians could themselves stop taking deliveries as a reprisal or the US Government could institute a blockade which would have the same effect on Talbot as an embargo.

3 Although a short-lived embargo, say one or two months, would necessitate laying off up to 2,000 workers or short-time working, reduce Talbot's revenue by some £11.5m a month and increase losses which are, somewhat optimistically, forecast to be £10m this year, it would not be likely to lead to termination of the contract and Talbot could be expected to survive.

4 An embargo which went on for 4 months would seriously embarrass the company. Its borrowings would rise by £23m leaving little to spare from short-term facilities and the business would have a "negative net worth" calling for a fresh cash injection or guarantees from its parent

PSA Peugeot Citroen (PSA), if it was to continue to trade legally. PSA might well be unwilling to provide the necessary funds or assurances and it would also become more likely that the Iranians would look elsewhere for future supplies, effectively terminating the contract.

5 Termination of the contract would, in addition:

a) Leave Talbot with stock and work in progress to a value of some £25m after allowing for a shipment on 9 May and disposals, mainly for scrap, of unrequired stock since there is no other market for the Iranian kits. Effectively £22.5m of this is covered by ECGD pre-shipment insurance;

b) Lead to upwards of 2,000 immediate redundancies, mostly at the Stoke (Coventry) engine plant at a cost of about £5m.

c) Give rise to losses for the current year of £70m plus.

In the present climate with under-utilised capacity in their French facilities and a falling market share throughout Europe, it is highly improbable that PSA would be prepared to foot this bill for their ailing UK subsidiary, let alone fund capital investment (which could amount to more than £100m) to introduce new products to ensure long term stability. Termination of the contract or a prolonged hiatus in deliveries is therefore likely to lead to liquidation or a receivership with at least a substantial subsequent reduction in UK manufacturing facilities and at worst total closure of the UK operation. In employment terms this would mean the direct loss of up to 20,000 jobs more than 6,000 of which are at Linwood in West Central Scotland. There would also be knock-on effects on suppliers which could be expected to put at risk a similar number of jobs, mostly in the West Midlands.

6 Three courses of action which could assist Talbot if its parent company wants to retain its UK manufacturing interests have been examined:

a) Stock-piling at the Government's expense;

b) Direct compensation for loss of profit;

c) Further support under existing Government schemes.

Following any of these routes would lead to pressure for support for other firms affected by the embargo and would make it difficult to resist similar pressure in other circumstances, particularly where Government action might be said to have put firms at a commercial disadvantage.

7 Stock-piling is not considered to be a useful or practical course to pursue. In the event that deliveries could be resumed after an embargo it would only delay the time at which lay-offs became necessary in order to clear the backlog in the pipeline, and if the contract was in fact to be terminated it would simply increase the volume of unsaleable product to be scrapped.

8 Direct compensation overtly presented as such would be expensive and could not be confined to Talbot alone - BL for example have £23m of annual business under current contracts and are hopeful of obtaining further orders worth £55m a year while other firms in the vehicle and associated industries are doing business with Iran at the rate of about £19m a year. If compensation were to be paid to Talbot for loss of profit while trade was suspended this would cost about £20m for a 4 month cessation on top of at least £400,000 a month which could be obtained under the Department of Employment's Temporary Short Time Working Compensation Scheme. Compensation for total loss of business would at least need to cover the incremental increase in losses this year of more than £60m, and further losses in subsequent years at, the rate of perhaps £40m a year. On this basis the sum required

could exceed £60m this year with an on-going commitment for several years of something of the order of £40m. These payments would simply keep the firm alive without doing anything more to assure long term stability. Additional support towards capital investment in new products and associated facilities would also be needed to ensure this which is unlikely to attract PSA at this time given their current under-utilisation capacity. In all these circumstances I do not consider that direct compensation should be contemplated.

9 Short of direct compensation some assistance could be provided under existing schemes. If there is some prospect of recovering the business and PSA is prepared to support Talbot - both of which must remain possibilities in the short-term - Temporary Short Time Working Compensation is likely to be available as an alternative to redundnacies and this would provide at least some £2.5m for the 6 months during which it can be paid. (The Company is likely to apply for £4.5m and Department of Employment Ministers are urgently considering whether the full amount could properly be met under the Scheme). Consideration could also be given to deferral or waiver as appropriate of interest on outstanding Government loans of £50m which would cost about £450,000 a month at current interest rates. These actions would ease the company's short term cash problems but would in no way prevent the worst consequences of a total loss of business. This could only be averted by massive rescue support under Section 7 and/or 8 of the Industry Act outside the present guidelines and needing EEC approval. The level of support needed would be on a par with that which was provided for in 1976 (up to £162.5m) and I do not believe that this could be justified in present circumstances. Consideration could, of course, be given at any time to a request by Talbot or PSA for a more modest level of support for any new viable capital investment they might be willing to locate in this country to ensure the long term stability of the UK operation. However, as has been indicated earlier in this note, there is little chance of such new investment being contemplated by PSA within a timescale which would prevent a very substantial run-down if not complete closure of Talbot's UK manufacturing operations.

CONCLUSIONS AND RECOMMENSATIONS

10 If current contracts are excluded from sanctions and no other factors arise to prevent deliveries being made and ECGD cover is maintained; the projected trade embargo would not of itself affect Talbot and no special action needs to be taken. Apart, therefore, from other advantages, the exclusion of current contracts would be far and away the best solution from Talbot's point of view and would also ease the problems of BL and other vehicle sector firms.

11 If current contracts are not excluded I do not recommend support towards stockpiling or direct overt compensation for loss of profit. If assistance is to be provided I consider that this should be confined to support which is available within the parameters of current Government schemes, ie

a) Maximum proper use of the Temporary Short Time Working Compensation Scheme to keep jobs in being;

b) Deferment or waiver as necessary of interest payments on the £50m of outstanding Government loans as an aid to cash flow; and

c) Support for any viable projects which might be brought forward by the company under Section 7 or 8 of the Industry Act to assist redevelopment of the business.

12 Any assistance would need to be considered in the light of the underlying viability of Talbot and its long term future as seen by PSA. In the present climate of the European motor vehicle assembly industry it does not, however, seem very probable that PSA will wish to create new capacity and therefore the most that we could seek to do is to enable Talbot to weather a short storm in the hope that it can recover its sales to Iran once an embargo is lifted. If it does not or the contract is terminated by the Iranians, the cost of preserving the company and inspiring the necessary capital investment for future stability would be

so high that I do not believe that we should contemplate it. Apart from financial considerations, such action would be a major movement away from our policy of allowing market forces to determine the success or failure of companies and open the door to other rescue requests. Assistance at any level apart from that which would be available to any firm in similar circumstances (ie TSTWC) would be bound to attract political attention in view of the circumstances surrounding the earlier support for Talbot; the more particularly if it called for significant departures from the published criteria for support under the Industry Act. We could not, of course, avoid informing Parliament.

13 Cost estimates can only be very rough. Temporary Short Time Working Compensation for 6 months could cost between £2.5m and £4.5m for Talbot employees only (without allowing for knock-on effect at suppliers) and the monthly cost of deferment or waiver of all interest on current loans would be some £450,000 a month at current rates. In the unlikely event that PSA did come forward with new product proposals, support of, say, 25% of the cost of a major new engineering investment could amount to £35m over a period of 2 - 3 years since such support would need to be "front end loaded". None of these sums have been provided for in current estimates or PESC provisions and additional financial provision would be needed.