

ENERGY

Ref: A09675

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PRIME MINISTER

Offshore Supplies Interest Relief Grants Scheme
(E(79) 6)

BACKGROUND

The provision of supplies for the offshore development of North Sea oil and gas represents a market now worth about £1,500 million a year. Because the United Kingdom Continental Shelf (UKCS) is regarded in law as part of the United Kingdom, United Kingdom export credit facilities are not available to British firms competing in this market whereas other countries can quite properly count it as an export market to which their export aids apply. United Kingdom suppliers were therefore seen, at an early stage, as potentially disadvantaged in this market and the previous Conservative Government introduced the interest relief grants scheme in 1973 to redress the balance - in a situation where, at least initially, the main competition came from the United States, Norway and Japan. Over the 6 years since the scheme was introduced (though not necessarily because of the scheme we have other advantages including proximity) the share of the market going to United Kingdom companies has increased from about a quarter to about two-thirds.

2. Although the EEC Commission raised no problems about the scheme in its early days they have become progressively more insistent that it distorts competition with other European suppliers and on 2nd May they issued a Decision which requires us to cease aiding new contracts after 2nd July on the grounds that such aid is contrary to the Treaty of Rome (intra-Community trade should not be aided as this distorts competition).

3. Arguments with the Commission about the validity of the scheme have continued now for some years. At an early stage of the argument the United Kingdom challenged the Commission's view that European suppliers were disadvantaged, on the grounds that many other EEC member countries in fact gave assistance to their own firms supplying goods to the UKCS despite

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despite the Treaty. We privately produced to them evidence to this effect but were told in mid-1977 that other member States either claimed not to provide preferential credits for UKCS trade, or, in the case of France, that they would no longer do so. We have never been able to get the Commission to accept that subsidised competition from third countries outside the EEC represents a problem for European manufacturers as a whole which ought to be tackled on a Community basis.

4. The last Government sought various ways of arriving at a compromise with the Commission - including being prepared to provide a United Kingdom subsidy for EEC components and sub-contracts where they represented up to half the value of a UKCS contract, but the Commission would not accept this (M. Vouel, the Commissioner concerned, is a particularly immovable and unimaginative Luxembourger).

5. There are thus three inter-related questions:-

- (a) Whether the scheme represents value for money irrespective of other factors.
- (b) Whether there is any way of deflecting or avoiding the Community's condemnation of the scheme.
- (c) If the scheme is ended how to present the decision in the most defensible way (given that its ending will lead to attack both on the grounds that the Government are placing the 100,000 jobs in the offshore supply industry at risk and that it is bowing to unreasonable pressure from the Commission).

6. Unfortunately Mr. Howell's paper does not give a clear lead on any of these questions. This is particularly unfortunate in the case of the first - value for money - on which the others depend. You will wish nevertheless to try and bring the Committee to a clear conclusion on each. Points are:-

- (a) Value for money. To aid a growing industry is one thing: to continue the aid when the industry is established is quite another. Mr. Howell's paper lists in Annex B contracts where he believes the existence of the IRG has influenced the placing of the contract

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in the United Kingdom. You might ask him whether they are a representative selection or the best case that could be made? With the exception of the first four they appear relatively minor put against the size of the market. You might also care to probe the remark in paragraph 5 of the paper attached to Mr. Howell's note that the United Kingdom offshore supply industry "has been and continues to be relatively uncompetitive on price". If true this shifts the argument from matching others' export aids to covering the deficiencies of our own industries. If aid were removed, would they pull their socks up?

- (b) The Commission. You have already said (Mr. Lankester's letter of 29th May to the Department of Energy) that you see objection to compromises which involve the United Kingdom taxpayer in subsidising our European competitors. Mr. Lankester also reports you as suggesting phasing out the grants over 18 months and leaving it to the Commission to decide whether, in these circumstances, they would pursue us in the Courts. This is an attractive course. It might even be possible to negotiate such a deal with the Commission though for a shorter period. But you might also care to ask, in parallel, for action to be taken to ensure that our European competitors also stick to the rules and to explore once again the possibility of a Community aid system to match third country competition (if one could be devised we might gain rather than lose money). Both steps would put us in an attacking, rather than a defensive, posture in an area where the Commission has been remarkably unimaginative.
- (c) Presentation. The most defensible situation would be one in which you could say that you had examined the scheme, come to the conclusion that it did not represent value for money and were accordingly bringing it to an end. But this might not accord well with a decision to continue it for a further 18 months. You might ask Mr. Howell, in consultation with the Paymaster General, to prepare the most advantageous public line in the light of the decisions taken.

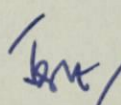
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HANDLING

7. You might first ask Mr. Howell to introduce his paper and then take the Committee through the questions listed above. The Foreign and Commonwealth Secretary, the Secretary of State for Scotland and the Secretary of State for Industry may all wish to contribute.

CONCLUSIONS

8. Subject to discussion the conclusions of the meeting might be:-
- (i) Either to bring the scheme to an end now or to phase it out.
 - (ii) Depending on (i) to invite the Secretary of State for Energy, in consultation with the Secretary of State for Foreign and Commonwealth Affairs, to negotiate a phasing out period with the Commission.
 - (iii) To invite the Secretary of State for Energy, in consultation with the Paymaster General, to consider the public handling and justification of the decision in the United Kingdom


John Hunt

31st May 1979