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MINISTERIAL COMMITTEE ON ECONOMIC STRATEGY

BRITISH SHIPBUILDERS FINANCES

Note by the Central Policy Review Staff

1. The paper from the Secretary of State for Industry, E(80) 103, discusses the state of BS finances and the new management's preferred strategy for the four specialist merchant yards (Austin & Pickersgill, Govan, Smith's Dock, Sunderland Shipbuilders) and the three mixed yards (Cammell Laird, Scott Lithgow, Swan Hunter). In summary:
 - (1) BS Finances. BS are forecasting a breach of £65 million to their EPL for this year and an excess over PES provision of £50 million for next. The Secretary of State accepts BS' view that the breach is now irreducible for 1980/81 and largely so for 1981/82.
 - (2) BS' Preferred Strategy. Their preferred strategy is to keep open all four specialist yards and all three mixed yards. (BS are, however, prepared to contemplate the closure of Smith's Dock). They plan to increase merchant shipbuilding at Swan Hunter, while switching the other two mixed yards, Cammell Laird and Scott Lithgow, out of merchant ships into oil rigs. The Secretary of State acknowledges that further closures might be necessary to reduce exposure to endless high subsidies but on balance recommends that BS' preferred strategy should be supported.
2. The CPRS is concerned about (a) financial discipline at BS, (b) the absence of a restructuring plan for the industry, (c) the continuing use of Government subsidies to win orders for yards that have no prospect of long-run viability, and (d) the costs and risks of taking two yards into the offshore business.

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Financial Discipline

3. As a starting point, BS must take their financing limits seriously. The CFRS sees at least three grounds for believing that they have not done so in the past:

- (1) The Buy British Policy. BS buy well over 90 per cent of their materials and equipment in the UK, mostly at a higher price than the equivalent imports. BS calculate that they could save £30 million in a full year by buying half their supplies from overseas (for example, special steels, boilers, pumps, pipework). It may be possible for BS to take a tougher line with their UK suppliers. But if they cannot get supplies at something like world prices, their policy to Buy British must be called into question.
- (2) Short-Time Working. It is the practice of yard management to keep people at work and to pay them even when they are idle. BS estimate that this year underutilisation (mainly payment for idle time and non-recovery of overheads) will cost them £36 million. Short-time working would be resisted by the unions, but it is an alternative that would significantly reduce BS' cash requirements.
- (3) Pay and Productivity. Productivity in BS is around half of that of their main competitors. Last year's pay settlement was conditional on a productivity increase. In the event, productivity actually fell, but the settlement was paid in full. BS need to be more resolute in their negotiations this year if they are to achieve a satisfactory settlement. At present they are assuming a settlement of up to 9 per cent. Given the state of BS' finances, Ministers may feel that this should be largely or wholly financed from productivity increases.
4. Ministers should therefore not be too ready to accept BS' assessment that little can be done to reduce their cash requirements. The CFRS suggests that BS should re-examine their policies on pay and productivity, short-time working, and purchasing. These and other aspects of BS finances should be further considered by Ministers before any decision is taken to increase the EFLs for 1980/81 and 1981/82.

5. There are clearly some shortcomings in the mechanism of Government control over BS. BS appear to have paid little regard to their financial limits and have planned ahead on the basis of excessive optimism and poor financial forecasting. BS have used Government subsidies to win orders for several yards of doubtful viability. There is a disincentive to examine further closures since these only worsen the financial position in the short term. Like the Secretary of State, we believe that the continued reliance on existing financial disciplines could be risky. We suggest that Government support should be made more selective, see Conclusion 14(i).

6. The CPRS view is that businesses in cyclical industries, like shipyards, should not be kept going with Government subsidies simply because they might cease to be loss-making one day when trading conditions are again favourable. The CPRS suggests that no merchant yard should be sustained through the present shipbuilding recession unless there can be reasonable certainty that from now on profits during the good years will outweigh losses during the lean. The CPRS believes that Ministers should ask BS to produce within three months a restructuring plan based on yards that pass this test of viability. BS' preferred strategy for the four specialist and three mixed yards does not seem to have been constructed on this basis.

Specialist Merchant Yards

7. Together these four yards employ nearly 11,000 on merchant shipbuilding. They have a combined annual capacity of 280,000 cgrt:

Austin & Pickersgill	Wearside	2,700 employees	100,000 cgrt
Sunderland Shipbuilders	Wearside	3,700 employees	80,000 cgrt
Covan	Clydeside	3,000 employees	60,000 cgrt
Smith's Dock	Teeside	1,500 employees	40,000 cgrt

8. None of the yards is currently profitable. Their combined loss this year will probably not be far short of last year's loss of £50 million. The two Wearside yards, Austin & Pickersgill and Sunderland Shipbuilders, are making only small losses and should soon return to profitability. Both yards might be viable in the long run. Smith's Dock and Covan are each heavily loss-making. Their long-run viability must be in doubt:

(1) Smith's Dock. The facilities at Smith's Dock are badly out-of-date. The yard must close eventually if, as according to the Department of Industry, the new investment essential to keep the yard open cannot

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be justified in terms of economic return. If no further order is placed at the yard, its workload would expire in just over a year.

(2) Govan. The yard has consistently made large losses in the past, and despite its modern facilities at Fairfields, seems set to be in continual need of loss financing in the future. Govan cannot be closed for another two years, because of the large order book it has been allowed to build up since the Liberty Maritime order at the end of last year.

9. BS' preferred strategy is to keep open all four specialist merchant yards by using Intervention Fund support to win orders. However, Department of Industry officials consider that, if pressed, BS would probably agree to close Smith's Dock at the end of 1981. The CPRS agrees with the Department's suggestion that, in backing a strategy for BS, Ministers should insist on the closure of Smith's Dock. The CPRS believes that Intervention Fund support should be confined to yards with prospects of long-run viability. We suggest therefore that the case for using Intervention Fund money at Govan should be brought to Ministers for decision urgently.

Mixed Yards

10. The mixed yards are even more unprofitable than the specialist merchant yards. The Ministry of Defence finds it advantageous to have the mixed yards. But when, as now, there is a severe cutback in naval requirements, an additional burden falls on BS. The mixed yards have a potential non-naval capacity of over 150,000 cgrt. Employment on non-naval building is currently only 3,400, but BS are planning to redeploy large numbers from the naval to the civil side of the yards.

Swan Hunter	Tyreside	1,800 employees	60/30,000 cgrt
Cammell Laird	Merseyside	nil	40/50,000 cgrt
Scott Lithgow	Clydewide	1,600 employees	30/40,000 cgrt

11. BS preferred strategy, in response to the future downturn in naval requirements, is to increase the building of merchant ships at Swan Hunter and to switch Scott Lithgow (Kingston yard) and Cammell Laird into offshore rig construction. Initially, at least, offshore orders can be won only at a loss:

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The prospective losses are caused partly because the offshore rig market is a fiercely competitive one in which BS have no proven track record, and partly because of BS' low productivity. We note the Department of Energy's observation that BS' man-hour assumptions seem to be more than twice that of continental competitors. The advice of the Offshore Supplies Office is that it would be unwise to allow BS to win initial orders by specifically quoting below cost unless either (a) BS can demonstrate where the productivity improvement will come from, or (b) Ministers are prepared to sanction the loss financing of further orders. The CPRS shares OSO's reservations and considers that any loss financing in this area should be dealt with selectively.

12. The CPRS question in particular whether it is necessary for both Cammell Laird and Scott Lithgow to enter the offshore business. There are grounds for believing that it would make more sense to concentrate submarine and oil rig work at Cammell Laird. The issues are complex and require parallel consideration of the UK's submarine strategy and offshore strategy.

Conclusions

13. In order to improve the short-term situation, the CPRS recommends Ministers:

- (i) To ask BS to re-examine policies that influence their cash requirements, in particular, pay and productivity, short-time working and purchasing;
- (ii) To ask that the results of this re-examination should be brought back to Ministers before new EFLs for 1980/81 and 1981/82 are agreed.

14. For the longer term, the CPRS recommends that Ministers give BS three months to produce a yard-by-yard restructuring plan for the industry so that early decisions can be taken on:

- (i) whether to prevent the use of Intervention Fund support at Smith's Dock and Govan. (Ministers may agree with the CPRS that a decision could be taken on Smith's Dock immediately);
- (ii) whether to allow loss-financing for offshore orders at both Cammell Laird and Scott Lithgow.

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