cc Mr Duguid

Prime Minister
Mr Nott's written contribution to the forthcoming E discussion on B.L. He is firmly against further funding.
MAP 5/1

From the Secretary of State

SECRET

PRIME MINISTER

I shall be abroad when E Committee resumes its discussion on the BL Plan; I should like therefore to elaborate on the views which I expressed when we discussed the matter before Christmas.

Whatever decision we take, we are in trouble.

If we refuse to fund the plan there will be a deluge of praise for Michael Edwardes and his achievement. It will be said that in spite of his splendid efforts the Government has pulled out the plug at the most inappropriate political and economic moment. We will be charged with the grossest insensitivity to jobs and activity.

If we agree to fund the plan, any lingering belief in the determination of this Government to support the wealth-creating private sector - and in particular the growth industries of tomorrow - will be hopelessly undermined. The financial and popular press will, I suspect, come to know at least the broad outline of the BL plan and they will tear it to pieces. Even at the end of the five year period, and on the heroic assumptions made within it, the group will only be showing a positive cash flow of £28 million following a further investment of over £1 billion. It therefore involves tying up £1 billion and more than 100,000 skilled and semi-skilled men in an enterprise which we know has no longer term future. In my view we would be ridiculed, and rightly so, since such an investment will be seen to be wholly contrary to the industrial and economic philosophy which we have been promoting for the past five years.

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So, is there a compromise arrangement? Something which saves us from the worst features of either course. According to Michael Edwardes, there is no sensible compromise. He was absolutely clear about it when he talked to us. He told us that the choice was either a full funding or a liquidation. If the better parts of the group are sold off, leaving purely the rump of BL cars, the management, he said, will disintegrate and the dealer network will collapse.

It is true that towards the end of the meeting he began to retreat from the stark choice of liquidation or full funding. He once again suggested that if we agreed to the plan he would, of course, make it his priority to go for collaborative projects as soon as possible. This is what he said a year ago. And where has it got us? We know of offers made to BL (for several of its parts) but almost without exception they have been rejected as being inadequate. Yet over the past year the situation of the group has continued to deteriorate and not a single one of BL's plants have been sold off to alleviate the cash drain. And central to the plan is the funding of the LC10. This is what the government will be agreeing to. Look at the figures; they don't begin to make sense.

At some point in time the Government is going to have to grasp the nettle of BL and take a gamble. Are we not better to take it three years before an election rather than be landed with the problem in say two years' time? And what are the grounds for believing that the maximum degree of profitable employment will be preserved in a situation where BL remains as one group under Michael Edwardes, rather than a collection of some

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separate plants in different ownership? And what is likely to bring about the optimum result, effective receivership or a centrally directed break up under ultimate political and DoI direction?

Is the reality of a liquidation quite as bleak as suggested?

If there was a clear decision by the Government not to fund the plan, but it was equally clear that the Government had accepted the responsibility to meet all the liabilities of BL, I think it is highly probable, contrary to what Michael Edwardes said, that there would be entrepreneurs - perhaps not yet in the motor car industry - seeking to pick up the pieces. Why should they not do so? They would acquire large assets for a nominal sum, and, apart from the investment of new working capital, they would be on a gamble with a limited downside risk, without responsibility for the accumulated debts. Is it really suggested that some businessmen will not come forward to run the newest and most modern assembly line in the world at Longbridge in which more than £200 million has been invested? Is it suggested that someone will not invest some working capital in Leyland Vehicles, whose fixed assets must be worth a considerable sum, taking the risk of whether they can turn it around? We know that John Brown has already made such an offer. We know that there have been several offers for Coventry Climax. We heard last week that Abell, the Managing Director of Leyland Vehicles, will himself take over Prestcold. We know that BMW is a possible for Landrover. We know that Ford are interested in selling Jaguar through their distributorships. We know that Honda is already involved in Cowley. With a moderate expenditure of working capital, and release from accumulated debt, their downside risk would be limited.

Michael Edwardes agreed that it would be possible to negotiate what he called "management contracts" but in practice they would be much different to that, so far as the Government was concerned. The "managers" would have the power of closure; they would subscribe working capital; they would have to decide for themselves whether to invest capital in new models or not; it might be hoped that they would acquire responsibility for liquidating outstanding creditors and debtors.

What of the liquidation costs?

In effect whether we fund the plan or allow the group to go into liquidation we are left holding the bills. If a strike or a rise in the pound forces liquidation in two years time we would be subject to two sets of costs instead of one. I understand that of the total liquidation costs approximately £400 million relate to net trade creditors. It seems to me that a proportion of these debts might reasonably be passed to those who would pick up the separate pieces in receivership. If not these debts are a cost to the Government. Another part of the liquidation cost (£930 million over three years) is said to be the impact on the PSBR of lower revenue as a result of closures but, as I have said above, I believe that much of this lost revenue might be avoided - as indeed might be the social costs - through people coming in to acquire the separate plants. Another major cost is the balance of present debt outstanding (about £900 million). In practice this debt would not necessarily need to be repaid but might be rolled over in the form of

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government stock in return. This would be a PSBR cost and might add marginally to interest rates; but the impact on the gilt market of a "no" to the BL plan might be far more favourable than any adverse consequences from an extra £900 million of gilts.

Much of the £3 billion estimated cost therefore is not a public expenditure cost but a PSBR cost and if many parts were picked up in receivership, a substantial proportion of this so-called "cost" would be saved. In the last resort everything depends on the preservation of the maximum amount of profitable employment. Nowhere is it clear that an agreement to fund the plan will preserve a single extra job in the medium term that liquidation may not itself preserve.

Finally, there is the question of the attitude of the Board. If we say "no money" and that immediately leads to the resignation of the Board, we are of course in deep trouble, but Michael Edwardes came close to saying that this would not be the position of the Board. I believe that he hinted that the Board would see it as their duty to remain and start the process of an orderly liquidation.

So the question is this. Will we preserve more political credibility and save more jobs by funding the BL plan, or by letting events run their course. Obviously the correct commercial decision is to say "no". There is no future for BL as presently constituted; the Board do not pretend it. The funding of the LC10 is a damage limitation exercise, not a commercial project. The claim that it is less "expensive" to keep it going than to liquidate, seems to me to be based on a whole series of questionable assertions. Much of the estimated

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PSBR cost is lost revenue from less activity - but this is a rather new way of assessing economic costs. It is a reason for keeping every downbeat business in being, and who is to say that the redundant will not find jobs? Who is to say that they will not lose their jobs, even if we fund the plan? Who is to say that the "cost" of committing all these resources in men and money in a wholly uncommercial activity is not greater than freeing £1 billion for more profitable activity elsewhere. It is a classic "crowding out" scenario. So it comes down to the simple problem, can the government take the political risk of saying "no"? I think we can. Until someone shows that BL, as presently constituted, can survive and prosper (and the Board is suggesting no such thing in the BL Plan) we would be better to let events take their natural course - and save as much profitable employment as possible in receivership.

SW

J. N.

Department of Trade
4 January 1981