



P.0648

PRIME MINISTERBritish ShipbuildersE(NI)(82)2 and 5

BACKGROUND

This is the first corporate plan which E(NI) has considered. Sponsor Ministers may therefore take this discussion as an indication of how, and how critically, E(NI) is likely to examine 'their' corporate plans.

2. All of British Shipbuilders' (BS) activities except warship production and repair are unprofitable; and since its establishment in 1977 the corporation has reduced drastically the scale of its merchant shipbuilding, where most of the losses are made (capacity down 33 per cent, employment more than halved to 17,000). Last summer's defence review will also greatly reduce demand for BS's warships: up to 14,000 jobs will be affected by 1985.

3. British Shipbuilders' corporate plan envisages that the Corporation will so far as possible retain its present scale of operations. In particular:

- (i) Merchant shipbuilding capacity and employment will cease to contract and will increase from 1983-84, with employment rising to between 21,000 and 22,000 in 1984-85.
- (ii) Job losses on naval work will be reduced by expanding work on offshore installations at Cammell Laird and Scott Lithgow; by increasing merchant work at Swan Hunter; and by trying to increase warship exports. But there will still be several thousand redundancies.

British Shipbuilders expect that under this plan, their finances will improve so that in 1984-85 they will earn a profit in historic cost terms (over £20 million after assistance from the Intervention Fund).



4. The Secretary of State for Industry invites the Sub-Committee:

- (a) to agree in general to BS's proposals; except that
- (b) there should be no increase in merchant shipbuilding employment unless orders are available "on the right terms";
- (c) to agree to his specific proposals on the Shipbuilding Redundancy Payments Scheme, BS work on offshore installations, engines, finance and the Intervention Fund.

5. In E(NI)(82)5 the CPRS criticise BS's plans and forecasts on two counts.

1 First, they argue that BS have not given sufficient weight to financial factors,
2 have failed to show in detail how their proposed strategy will make BS profitable
3 and have not provided projections for individual yards.

6. Secondly, they point out that BS's profit forecasts appear to be too optimistic. They assume both an improvement of productivity of about 45 per cent between 1980-81 and 1984-85 and a continuing improvement in the world market for new ships over the next two years. The productivity target is high, although BS are starting from a low base (about the lowest in Europe). The demand forecasts are more open to question. They assume a sustained increase in real prices and in the profit margins which Japanese shipbuilders will build into their ship prices. But the Japanese are themselves under pressure from lower cost Korean shipbuilders; and it is likely that prices will turn out lower, and shipbuilding less profitable than BS assume. The note by Department of Industry officials attached to the Secretary of State's proposals echoes this criticism.

7. The CPRS suggest that Ministers should not endorse plans for merchant shipbuilding beyond 1982-83, and should press BS to produce better financial information in their next corporate plan, including an analysis of proposals for each major yard: meanwhile BS should be told that Ministers will only agree to expansion at the main merchant yards if they can obtain orders on which they can make profit without any assistance from the Government. The CPRS also emphasise the importance of establishing, soon, clear long term objectives for BS, which the Secretary of State for Industry's memorandum says he intends to do.

MAIN ISSUES

Merchant Shipbuilding

8. The question underlying decisions about British Shipbuilders, and especially its merchant shipbuilding, is how far the Government wishes or is obliged to resist the competitive pressures which would probably cause a further rapid and substantial reduction in BS's operations. Although the Corporation's financial position is improving, there must be considerable doubt about whether a number of its yards can ever hope to compete successfully, without subsidy, with efficient Japanese and Korean manufacturers. Some yards may be able to compete in producing fuel efficient, high technology ships; but the Corporation may be unable to make the best of such strengths as it has if it tries to keep inefficient yards running as well. In principle the Government could decide to withdraw Intervention Fund support before 1984-85; and set stiff profitability objectives for BS.

9. Such a course would lead to shipyard closures; and would be contentious. In particular:

- (a) Closing down a shipyard leads to substantial additional cash requirements; and writing off the yards concerned immediately worsens profits. Most of BS's shipyards are in areas of high unemployment; few of those who lost their jobs would find alternative employment; effectively the choice is therefore in many cases between paying unemployment benefit for some years and subsidising BS employees at least to produce something. But much the same is true of other closures both in the private sector and in the nationalised industries; and in a number of cases the Government has decided that there is no point in continuing to subsidise activities which have no realistic long term prospects of viability.
- (b) Shipyard closures in the next few years will be more clearly the result of Government policy, and perhaps be more strongly resisted, than have closures in recent years. It is less difficult to argue for closure when there is simply no work for a yard, as has been the case with some BS closures, than when a yard is closed because it is not



sufficiently profitable. Enough work can probably now be obtained to keep merchant shipbuilding at its present level; over the next three or four years BS itself wants to expand such work and will blame the Government if its plans are frustrated. If closures led to industrial action, BS would incur extra costs through being unable to complete its contracts on time.

- (c) The Chairman of British Shipbuilders, Mr Atkinson, might resign if the Government did not approve BS's proposed strategy.

10. There are two questions on which the sub-Committee should attempt to reach a view in the light of these considerations:

- (a) What criterion should be used to determine the future scale of BS's merchant shipbuilding activity?

The most stringent approach would be to require that, after some future date, no new orders should be taken on unless they are likely to pass some previously agreed profits test without Intervention Fund payments or other subsidy, that yards which did not get business on that basis would close down, and that employment in merchant shipbuilding would contract accordingly. The CPRS suggest that this criterion of profitability without subsidy should be applied somewhat less stringently/^{ie} to proposals to expand merchant shipbuilding from 1983-84 onwards. The Secretary of State proposes that such expansion should only be permitted if orders are available on the right terms, without saying what "the right terms" would be; and that BS's long term objective should be to attain viability by the end of 1984-85. But "viability" is an imprecise concept; and, however it is defined, BS as a whole might be able to continue in business while retaining loss making yards.

- (b) Should the Government approve BS's plans for the period to 1984-85 or, as the CPRS suggest, approve the plans only for the sectors other than merchant shipbuilding, where endorsement would be confined to 1982-83?



11. E(NI) will not be able at this meeting to reach agreement in detail on long term objectives for BS or criteria for new orders: there are technical decisions about for example the definition of profitability which the Secretary of State could be asked to sort out with the Treasury, the CPRS and other interested Departments, with a view to getting E(NI) approval in due course.

Offshore work

12. BS's construction of offshore rigs is subsidised, although at a lower rate than merchant shipbuilding; and the Corporation do not expect to break even on this work during the corporate plan period. It is however unlikely that any member of the sub-Committee will object to the Secretary of State's proposals that E(NI) should confirm the policy which E Committee approved in 1980 and under which Ministers have collectively to approve any proposal to take an order at a loss. (E(80)38th Meeting, Item 1).

Shipbuilding Redundancy Payments Scheme

13. This scheme provides benefits which are considerably more generous than those available to workers in most industries under the normal statutory redundancy arrangements, although broadly comparable with the redundancy schemes in steel and coal. The Secretary of State for Industry proposes that the terms should be improved. The best course would probably be for the Secretary of State for Industry to seek agreement to this proposal outside the meeting: Treasury Ministers may well suggest that in the first instance officials should be asked to evaluate the Secretary of State's proposals.

Engines

14. The Secretary of State for Industry proposes that consultants should investigate whether there is over-capacity in slow speed marine engines in the British shipbuilding industry, taking into account not just BS's own facilities but also those at Harland and Wolff. No member of the sub-Committee is likely to object.

Intervention Fund and Other Financial Support

15. The amount and terms of the Shipbuilding Intervention Fund are settled annually and have to be negotiated with the European Commission. The Secretary of State proposes



that for the twelve months beginning in July £40 million should be available (£5 million less than this year) and that the maximum level of assistance should be reduced by up to 5 percentage points below the present rate of 18 per cent of the contract price.

16. The Chief Secretary may argue for a figure below £40 million and a reduction in the maximum rate of assistance by the full 5 percentage points to 13 per cent.

17. The Secretary of State proposes that BS's External Financing Limit (EFL) should be set at £125 million in 1982-83 and that for that year BS should also be set a loss limit of £10 million after assistance from the Intervention Fund. I understand that the Chief Secretary has already provisionally agreed to the EFL figure and is likely to be content with the £10 million loss limit.

18. The Secretary of State also proposes increases in the PES provision for British Shipbuilders in 1983-84 and 1984-85 above the totals previously agreed on a provisional basis. The Secretary of State's proposals may be overtaken if the sub-Committee is unwilling to endorse BS's corporate plan; but in any case the Chief Secretary is unlikely to agree to increase the Corporation's PES provision at this meeting, partly because the figures are affected by capital expenditure on the Trident project, whose implications are still being discussed at official level.

19. The Secretary of State may well want to register the point at some stage that closing shipyards or other BS establishments would increase the public expenditure totals.

HANDLING

20. The best course would probably be for the sub-Committee first to discuss merchant shipbuilding; and then to turn separately and probably much more briefly to the other topics listed in paragraphs 12 to 19 above.

21. It will be for the Secretary of State for Industry to take the lead on merchant shipbuilding and the general question of the Government's attitude to BS's proposed strategy. Mr Ibbs will wish to present the CPRS paper; and the Chief Secretary will want to comment generally. The Secretary of State for Trade will probably wish to comment on the outlook for the shipping industry both in the United Kingdom and elsewhere in the world and its implications for British Shipbuilders; the Secretary of State for Defence, British Shipbuilders' largest customer, may also have some insights into the way the Corporation does and could run its affairs. Other members



of the sub-Committee may want to comment generally.

22. So far as the Secretary of State's other proposals are concerned, you could merely ask whether any colleague objects to any of them. The Chief Secretary is likely to be the main or perhaps only critic, although any member of the sub-Committee may have general comments to make. The Secretary of State for Northern Ireland has an interest in, but probably no objection to, the proposed study of engine building capacity in the United Kingdom through his responsibility for Harland and Wolff.

CONCLUSIONS

23. You will want to reach conclusions on the following matters:

- i. in relation to BS's strategy:
 - a. whether this should be endorsed, as the Secretary of State for Industry has proposed, as a whole, including the strategy for merchant shipbuilding subject only to the reservation that expansion in 1983-84 and later could take place if orders were available on the right terms;
 - or b. whether, as the CPRS has proposed, the plans for merchant shipbuilding should not be endorsed beyond 1982-83, with expansion only if orders could be taken on terms which would enable the yards to trade profitably without Government financial support;
 - or c. some other variant.
- ii. whether the Secretary of State for Industry should be invited to do further detailed work on framing long-term objectives for BS, in consultation with the Treasury and CPRS, with a view to approval by E(NI) in due course;
- iii. whether, as the CPRS has proposed, BS should be pressed to produce better financial information in their next Corporate Plan, including an analysis of proposals for each major yard;



- iv. whether the Secretary of State for Industry's proposals should be accepted on:
- a. the Redundancy Payments Scheme (para 10 of E(NI)(82)2);
 - b. Offshore (para 11);
 - c. Engines (para 12);
 - d. Finance for 1982-83 ie an EFL of £125 million and a loss limit of £10 million after Intervention Fund assistance (para 13);
 - e. Intervention Fund ie a further tranche of £40 million and a reduction in the percentage by up to 5 points (para 14).

Pg
LONDON
P L GREGSON

9 February 1982



PRIVY COUNCIL OFFICE
WHITEHALL, LONDON SW1A 2AT

17 November 1981

NSPM

✓M/R

How Sam,

BRITISH SHIPBUILDERS: PRIVATISATION

Thank you for your letter of 16 November, which I have shown to the Lord President. Mr Pym is happy with a reference on the lines that you suggest, but is concerned not to pre-empt future QL decisions, or to seem to give a commitment. He therefore suggests that the form of words should be amended to read as follows:

"It is the Government's aim to take powers this Parliament, if time permits, to facilitate private investment in British Shipbuilders."

You agreed to let me know, when we discussed this on the telephone, if these amendments caused you any difficulty.

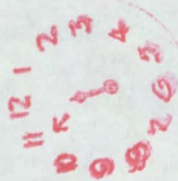
I am copying this letter to the recipients of yours and also to John Halliday, Home Office.

*Yours ever,
David.*

D C R HEYHOE
Private Secretary

I K C Ellison Esq
Private Secretary to the
Secretary of State for Industry
Ashdown House
123 Victoria Street
London SW1E 6RB

17 NOV 1981





Secretary of State for Industry

DEPARTMENT OF INDUSTRY
ASHDOWN HOUSE
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TELEPHONE DIRECT LINE 01-212 3301
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16 November 1981

David Heyhoe Esq
Private Secretary to the
Lord President
Cabinet Office
London SW1

NBPM

Dear David

BRITISH SHIPBUILDERS: PRIVATISATION

You will remember that E(DL) decided on 23 July (E(DL)(81)3rd, item 1) that the Government should make changes in the statutory framework under which British Shipbuilders operated partly so as to facilitate the disposal of parts of the Corporation to the private sector. It was subsequently decided by Cabinet (CC(81)32nd) that the Shipbuilding Industry Bill should not include provisions on privatisation because of pressure on the Parliamentary timetable.

2 On this basis the Shipbuilding Bill, which is due to receive its Second Reading tomorrow, Tuesday, 17 November, contains provisions which merely increase British Shipbuilders' borrowing limit and prolong the Shipbuilding Redundancy Payments Scheme. However, my Secretary of State and Mr Lamont, the Minister of State, who will be making the Second Reading speech, have decided that the speech should say that:.

"It is the Government's intention to take powers this Parliament to facilitate private investment in British Shipbuilders".

3 In view of the earlier discussion and since the proposed statement does not amount to a firm commitment to introduce legislation my Secretary of State thinks there is no objection to Mr Lamont speaking on the lines proposed. My Secretary of State thought, however, that the Lord President would wish to know the line being taken.

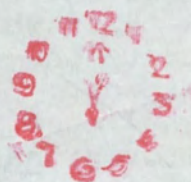
4 I am copying this letter to Michael Scholar (No 10), Peter Jenkins (Treasury), Murdo McLean (Chief Whip) and David Wright (Cabinet Office).

Yours ever

Ian Ellison

I K C ELLISON
Private Secretary

16 NOV 1981



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GC A. Duguid
A. Waller



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From the
Minister of State

Norman Tebbit MP

Rt Hon Leon Brittan QC MP
Chief Secretary to the Treasury
Treasury Chambers
Parliament Street
London SW1

MB

Ann Thorne

21st July 1981

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24/7

D Leon.

I am writing to let you know where we have reached in our consideration of the Corporate Plan for British Shipbuilders (BS) and our timetable for completing the work.

BS's Corporate Plan, submitted at the end of May, proposed no further contraction in merchant shipbuilding. Merchant shipbuilding employment since vesting day 1977 has contracted from 39,000 to 18,000 and BS now feel that the market and prices are going to improve further. They also have to take into account stiffening union resistance to further contraction, as the closure of Robb Caledon (Dundee) due to be completed in September has amply demonstrated.

Officials from all the Departments concerned have been engaged in discussing with BS their detailed plan for merchant shipbuilding, shiprepair, marine engines and offshore. As a result of these meetings, BS have been asked to examine certain alternative assumptions. We have asked them to assess the effect upon their merchant shipbuilding plan of a further tranche of Intervention Fund of no more than £35 million when the tranche of £45 million runs out in mid-1982; they have also been asked for an assessment of the effect of a £25 million tranche, or alternately zero, and the effect of a real price increase in ships being 4 percentage points less than the level they are assuming. Their response to these questions will help us to examine options on various levels of support and, in particular, whether we should be content with the prospect of somewhere near breakeven next year after crediting Intervention Fund assistance, or whether we should use financial pressure to force further contraction in 1982/83 and 1983/84. In the latter event this could mean temporarily higher expenditure due to closure cost. Shipyards can be closed only on completion of existing contracts and further contraction would also give rise to severe difficulties on the timing and presentation of closure decisions.

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However, I do not expect to be able to put proposals to colleagues on shipbuilding strategy until towards the end of September. BS need to take on board for their Corporate Strategy the Defence Programme changes announced by John Nott on June 25, and discussions between BS and MOD on the implications of the changes have now been initiated. The discussions will have to be set in the context of MOD's short and longer term budgetary constraints and these will involve some continuing uncertainty, but I would hope that by September all possible clarification of the short-term position will have been achieved.

The reductions in future surface warship orders has, of course, not only implications for specialist naval shipbuilding capacity but also for merchant shipbuilding capacity in places like Swan Hunter which build both naval and merchant ships, and we shall need to consider the contraction on the naval side in the context of policy towards the industry as a whole.

In the meantime, as you know, I have put forward proposals to colleagues which will be considered shortly to facilitate the introduction of private capital into BS at the appropriate time so that we can take maximum advantage of the need to raise BS's borrowing limits next session.

Copies of this letter go to the Prime Minister and Members of E(EA).

A handwritten signature in dark ink, appearing to read 'Norman Tebbit', with a horizontal line underneath the name.

NORMAN TEBBIT

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22 JUL 1984

Nat. Ind :

June 1979

Shipbuilding Policy -