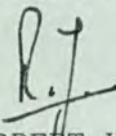


PRIME MINISTERAVIATION COMMITTEE OF CONSERVATIVE MPs

On January 17th, the Aviation Committee will press you for launch aid for the Airbus A320 and the Rolls Royce V2500 collaborative engine. (The Chairman, John Wilkinson, wrote in this vein to the FT on Tuesday last, and his letter is copied below.) The day before your meeting, MISC 25, the officials' group on the aerospace industry, will be taking DTI papers on both projects. A recommendation to E(A) or E(NI) from MISC 25 should be ready in late January or early February.

On present evidence, there are good grounds for caution in the face of the Aviation Committee's enthusiasm, so on the 17th we suggest you remain a tinge sympathetic, but cautious and not yet ready to make any commitment.

Briefs are attached on A320 and V2500.


ROBERT YOUNG
13 January 1984

Government launch aid for the A320 Airbus

From Mr J. Wilkinson, MP

Sir, — May I add my voice to appeals that have already been made by such authoritative bodies as the Society of British Aerospace Companies and the Air League to the Government to provide launch aid recoverable on sales for the A320 Airbus project?

Traffic figures now indicate clearly that the recession in civil air transport is ending and there is little doubt that airlines will be seeking to replace ageing, noisy, narrow-body airliners such as the BAC 111, Boeing 727 and 737, DC9 and Trident with new equipment that is not only more fuel-efficient but also meets the noise regulations that will be widely prevalent in the latter part of this decade. The market for new airliners in this category is well over 3,000 aircraft by the year 2000.

Increasingly airlines will substitute an entirely new airliner, rather than a derivative

of an existing type to meet their requirements in the 150-seater category, and will demand an aeroplane with optimal passenger appeal, good operating economics and the most up-to-date engineering technology.

At present there is only one potential such aircraft — the Airbus Industrie A320 which has already been ordered from the drawing board by four airlines, including British Caledonian. When the original A300 was launched it had no prior orders. Today Airbus Industrie is the sole effective competitor to Boeing and no less than 350 A300s and A310s have been ordered. Furthermore, British Aerospace has built the wings of those existing Airbus with out a penny of British Government launch aid.

If the British Government is to have an industrial strategy which looks to the future and builds upon success rather than merely subsidising loss-making nationalised industries, it must

support launch aid for the A320. To fail to do so would cause grave complications for British Aerospace's position on the Airbus consortium and there is every likelihood that Airbus Industrie would find another manufacturer to build the wings of the A320.

If the Government wants to promote the interests of hard-pressed Rolls-Royce, one of the best ways would be to guarantee with launching aid British participation in the A320 Airbus. The futures of British large civil airliner manufacture and of Rolls-Royce are inter-related. The A320 is the most probable candidate for the new Rolls-Royce V2500 five-nation consortium engine, and so powered could meet British Airways' requirements very nicely. John Wilkinson.

(Chairman, Conservative Aviation Committee.)
House of Commons, SW1.

AIRBUS A320 150-SEAT AIRCRAFT

1. British Aerospace are seeking 100% launch aid, equivalent to £461 million at outturn prices, for the wings for A320.

Their commercial case is poor. The expected real rate of return, at just over 4%, is below the Treasury norm for a low-risk project; the A320 is very high risk. Particular vulnerabilities are:

- the aircraft selling price, which will be heavily influenced by Boeing: the market might dictate too low a price
- the dollar/pound exchange rate, where anything in excess of \$1.60 between 1988 and 2003 will reduce the rate of return
- and the price of aviation fuel. BAe assume a 50% real rise over 6 years to make it worthwhile for airlines to invest in new technology fuel efficient aircraft.

Technologically, A320 is not a high risk venture, and the price of the plane can be manipulated to yield the forecast 600-700 sales, but it is extremely doubtful whether A320 will make any profit for the Airbus partners.

2. On launch aid, there is no precedent for 100% assistance, and A320 is certainly not the case on which to establish a precedent. The maximum extent of launch aid granted since its inception in 1949 has been 50%, and even then only two out of 40 cases have ever paid back in real terms - the Vickers Viscount airliner and the Rolls Royce Dart engine.

3. As to UK technical skills, designing the A320 wing will be intellectually demanding. But it is unlikely to require more than normal incremental developments in the down-stream disciplines. Although continuing UK experience with carbon fibre materials will be useful, there is no widespread fall-out of technical benefit to other industrial sectors.

4. The net employment effect is difficult to forecast. Within BAe, the A320 programme might, at its 1990/91 peak, absorb 1,000

more employees than are currently engaged on the A300 and A310 programmes. If BAe does not go ahead with A320, and A300/310 runs down as planned, BAe will have to shed 5,500-6,000 employees. The effect on BAe's sub-contractors' employment is as yet unclear. But we can hazard a guess that the final increase is unlikely to exceed 2,000/3,000, while the decrease could be 8,000/9,000. We could well find that, because of timing, decreases start before increases.

5. Lobbying has been intense. Its impact, we suggest, should be taken seriously. BAe have effectively cast HMG as arbiter of the Company's role in A320, and, by extension, of the UK's place in civil aircraft manufacture. Sir Austin Pearce has repeatedly (and misleadingly) avowed that HMG will get its money back "with profit and interest". He has drawn heavily on the public perception that employment in high technology is a virtuous thing. Both BAe and the Conservative MEPs to whom I have spoken have emphasised that A320 gives us the need and opportunity to be seen as good Europeans, with consequential industrial and political benefit. In fact, nobody in public has yet raised a voice against A320. Yet BAe are not prepared to venture a penny of their own shareholders' money. Why not? We did not denationalise BAe in order to carry on picking up the bill for any risky venture they are suspicious of for their own shareholders.

One last qualitative point, not yet raised by the lobbyists, is that £X-million risked on A320 is better than the same number of millions thrown away on British Shipbuilders or British Steel. Some potency in that?

6. At this stage, any conclusion should be tenative. Commercially, the right amount of launch aid - and the place to start negotiating - is zero. DTI should be made to fight for every percentage point, on the grounds that the commercial case is frail and that launch aid should be the minimum needed for presentational purposes. I shall ask MISC 25 to ponder the benefit of allowing BAe to keep the proceeds of a sale of HMG's 23% "surplus" shareholding (it owns 48% as against a commitment to retain 25%). At today's share price, a 23% holding is worth £107 million, equivalent to 23% of launch costs at outturn prices and 31% at 1983 prices.

R.J.

13 January 1984

ROLLS-ROYCE V2500 COLLABORATIVE ENGINE

1. Rolls-Royce are proposing to participate, with Pratt and Whitney and Japanese, German and Italian companies, in a new joint company which will develop, make and market a new 23,000lb thrust engine, aimed principally at the market for 150-seat civil airliners. RR's 30% share of the development cost is £226 million, and they seek launch aid of £113 million (50%).
2. Strategically, collaboration is absolutely right for RR. HMG has been pushing the company this way for years, and they are responding.
3. Commercially, RR's case for HMG's approval of the project is strong, far more so than for A320. The V2500 will enjoy a strong competitive position across a wide front of aircraft - not only A320, but all the competitors to A320, too. It will have only one rival - an ageing GE design, which, even with development, will not be as fuel efficient as V2500. Even on conservative assumptions, the real rate of return on the V2500 project is between 9% and 10%.
4. Technically, V2500 does not take a quantum leap forward, but pushes on with current know how possessed by the partners. Like A320, it is an important intellectual challenge, but the industrial benefit does not spread widely.
5. As to employment, V2500 is expected to absorb about 3000 employees at RR and a slightly greater number at suppliers. But, as other programmes run down and companies seek higher labour productivity, we should not expect much if any nett increase.
6. The DTI paper submitted to MISC 25 is astonishingly lightweight on the legal and management aspects of the joint company. Although the commercial and technical elements of the V2500 case might encourage you to be bullish with the Aviation Committee, caution on the legal front is necessary for now.
7. The amount of launch aid to be offered will have to be determined, not in isolation, but in the light of need as portrayed in the new RR Corporate Plan and as influenced by privatization.

/Sir William Duncan

Sir William Duncan has (rashly) said that RR would go ahead without launch aid. A zero offer is not practical politics, but 50% is an absolute maximum.

8. Tactically, we feel you should insist on treating the A320 and V2500 proposals separately. Approval of the one does not logically require approval of the other. Since they make competing claims on the same finite funds, you may eventually find that launch aid to RR is a useful means of levering down aid to the much more dubious A320 project.

R.J.

12 January 1984

