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PRIME MINISTER

BRITISH SHIPBUILDERS
[E(A)(86) 15th Meeting]

[Letter of 2 May from the Secretary of State for Trade and Industry to the Lord President; letter of 7 May from the Secretary of State for the Environment to the Secretary of State for Employment; letter of 7 May from the Secretary of State for Employment to the Prime Minister]

MAIN ISSUE AND DECISIONS

1. The main issue is whether there is any case for seeking to delay or influence the substance of the proposed announcement by British Shipbuilders (BS) on 14 May (next Wednesday) of their intention to close three yards; whether the Government should announce an employment initiative to ameliorate the effects on the North East; and if so, how it should be financed. Subject to the discussion, you may wish to reach decisions to:

(i) accept that BS must proceed as they have suggested;

(ii) invite the Trade and Industry Secretary to discuss the EFL and CSL with the Chief Secretary;

(iii) subject to settling how it should be financed, invite the Employment and Environment Secretaries, in conjunction with the Trade and Industry Secretary and the Chief Secretary, Treasury to formulate a proposal for an employment initiative to be announced also on 14 May.



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BACKGROUND

2. On the last two occasions E(A) has discussed the BS Corporate Plan (ie July 1984 and 1985) it has recognised that there is no prospect of BS becoming commercially viable, and the company has been set on a downward glide path from an annual order intake equivalent to 230,000 compensated gross tonnes (CGT) in 1984/85 to 115,000 CGT in 1987/88. EFLs and Contract Support Limits (CFL) have been set accordingly. Under this regime, the size of the industry depends on its performance in the market place, and in particular on its ability to win new orders.

3. Merchant shipbuilding capacity has already fallen from over 600,000 CGT a year at the time of nationalisation in 1977 to about 250,000 CGT a year now, while employment has fallen from nearly 40,000 to 9,000. BS's planned order intake for 1985/86 was 200,000 CGT. In fact they won only 23,000 CGT. This reflects the slump in the world market for ships. World wide orders last year amounted to only 8 million CGT, compared with 21 million in 1974. Even the Japanese have had to cut capacity, perhaps by up to 30 per cent. Against this background the BS board have concluded that they should aim to make substantial reductions in capacity in the least costly manner.

4. On the basis of their preferred (optimistic) scenario, they will have to close three yards over the next few months, cutting 3,500 from their labour force of 9,000. The closures would be:

Wallsend Engine Works	400 jobs	-Whitby
Smith's Dock	<u>1,500</u> jobs	-end of year.
Ferguson - Ailsa Yard as Troon	<u>400</u> jobs	-Sept.


CONFIDENTIAL

3 1/2 thousand

Reduction at other yards 1,200 jobs

On a less optimistic scenario further closures would be required at:

Austin and Pickersgill 1250 jobs
Ferguson Yard as Port Glasgow 400 jobs

The Board's proposal is to close the first three yards as current work is completed at the end of the year. But they feel very strongly that they should brief the unions clearly at a negotiating meeting on pay to be held on Wednesday 14 May.

Scope for Government Action in Relation to BS


E(A) will need to consider 3 issues:

1. Are the Board's proposals realistic given BS's market outlook?

2. Are there any wider national or strategic reasons for retaining surplus BS capacity?

3. Are there any steps the Government can take to provide work for BS?

6. There seems no reason to doubt the Board's commercial judgement. They secured last year less than an eighth of the volume of new work for which they had planned, and many of their yards will have nothing to do beyond the summer. In the short term, they clearly have substantial surplus capacity. But at some stage there is likely to be some upturn in demand - perhaps in the early 1990s. Cabinet Office was commissioned on 17 April



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to set in hand an inter-departmental study of the future of the UK shipbuilding industry. This is in train under my Chairmanship, and will cover these issues, but the work will not be complete for several weeks. You may therefore first wish to explore whether there is any case for postponing an announcement of intended closures until the government has had an opportunity to consider the longer term prospects. I suspect, however, that the Board are right in saying that on any realistically foreseeable scenario BS have too much capacity, and that therefore they are also right to make an early announcement about closures.

7. Even if there is no commercial case for retaining the capacity, it might be argued that there are wider strategic on defence factors for doing so. Again, the Cabinet Office review will consider this question. But as BS yards are not involved in warship building, where there is also likely to become spare capacity, even closing all the yards remaining in BS ownership seems unlikely to produce a situation in which the UK would be unable in the future to build civil or military vessels which could not be purchased elsewhere. Maintaining a labour force with no work to do would be costly and demoralising, and any physical facilities which seemed likely to be needed in the future could presumably be mothballed.

8. An alternative would be for Government to help BS find additional work. The first possibility is naval procurement. BS have been lobbying hard to sell MOD their fleet support vessel, but at present MOD have no operational requirement for it, and no money in their budget. And even if there were a requirement, there would normally need to be a competition, in which the privatised warship yards would wish to compete. So while the Defence Secretary might be asked about the possibility there seems little prospect that an MOD order can be forthcoming in the

CONFIDENTIAL


CONFIDENTIAL

near future; and if there were any such orders they would be likely to be at the expence of MOD warship orders, so transferring the problem to other yards (of which the most vulnerable, Swan Hunter, is also in the North East).

9. The second possibility is to provide additional Government support. Payments to BS to meet losses have to be kept within limits agreed within the European Commission, since they constitute "state aid". Subsidies to overseas purchasers under the Aid and Trade Provisions might escape this restriction, and the Trade and Industry Secretary might be asked to report on the scope for this. But Japanese and other European competition for such orders could be severe and we could find ourselves in a very costly matching exercise, which would also be quite contrary to the thrust of our trade policy.


External Financing Requirements

10. It is clear that BS's EFL and CSL will need revision given the poor state of their order book, and the need to cover redundancy costs. This might be remitted to the Trade and Industry Secretary and the Chief Secretary, Treasury to resolve bilaterally.

Action to Mitigate Unemployment in the North East

11. The bulk of the redundancies will be in the North East, where unemployment is already significantly above the national average. When discussing the AOR order, E(A) expressed great concern about the situation, and there will be strong pressure for a Government job creation initiative. The Environment Secretary had proposed an expansion of the urban programme and derelict land grants, focused on economic rather than social schemes. The Employment

CONFIDENTIAL


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Secretary had proposed the creation of an Enterprise Corporation on the same lines as those used by British Steel and British Coal, or an Urban Development Corporation for Teeside (formally matters for the Trade and Industry Secretary and Environment Secretary respectively) or an expansion of the English Industrial Estates Programme, as well as focussing MSC programmes in the North East. E(A) will not have sufficient information to reach firm decision on any of these proposals. But the key issue is whether, unless offsetting reductions can be found, additional resources can be made available for an initiative. I suggest that you ask the relevant Secretaries of State together with the Chief Secretary to prepare urgently a suitable package from the various suggestions.

12. The Treasury can be expected to argue that the Government has not launched any special initiative to mitigate the effects of previous BS restructuring (which was on a far larger scale than that now proposed), that any additional resources for the North East should be found from within existing programmes, and that any decisions should be deferred for proper consideration within PESC. These are powerful considerations. But the case for an initiative is essentially political. The scale of the redundancies is not enormous in relation to the population of the areas affected. But the recent decline of traditional heavy industrie in these areas (including coal and steel as well as shipbuilding) has left their industrial structure and urban environment in a very poor condition, and there are few signs of hopeful developments. In the light of this it appears that the Chief Secretary may accept that there is now a political imperative for the Government to be seen to demonstrate its concern for unemployment in the North East. You may therefore wish to consider the possibility of an initiative costing, say, up to £20 million over 3 years, being formulated and announced in parallel with BS's



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announcement of redundancies, and invite the relevant Ministers to agree on the components over the weekend.

HANDLING

13. You will wish to ask the Secretary of State for Trade and Industry to introduce the discussion. The Secretary of State for Defence will wish to speak about the prospects for naval procurement, and also as Member for Ayr in which the Ferguson Ailsa yard is situated. The Secretary of State for Employment and the Minister of State for Urban Affairs (Mr Patten) will wish to speak on the possibility of a job creation initiative, and the Chief Secretary, Treasury will wish to comment on the expenditure implications

J B UNWIN

7 May
Cabinet Office