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PM seen  
File

7 July 1986

Dear David,

PRIME MINISTER'S MEETING WITH SIR EDWARD DU CANN : 8 JULY 1986

I attach some supplementary briefing for the Prime Minister's meeting with Sir Edward tomorrow. It covers the decline in the fleet, what we have done to help the shipping industry and why we have not done more. But officials here have asked me to point out that these points have all been made to Sir Edward on earlier occasions and have had little effect. Moreover, we are not on particularly strong ground on our civil resupply capability, which is why my Secretary of State will be putting proposals to E(A) before the Recess. You should also note that Sir Edward has written a pamphlet on shipping, which he offered to the CPC for publication. I understand that the CPC have refused this request. The Conservative Research Department helpfully made a hidden copy of the pamphlet available to us. This is attached, along with an analysis by officials of Sir Edward's main points and their relation to Government policy. I should be grateful if you could treat the pamphlet in confidence : Sir Edward is obviously unaware that we have a copy, and if you could let me have it back after the Prime Minister's meeting

Yours Sincerely

Jon Cunliffe

P.S. The earlier briefing, of which you have a copy is included for completeness. A copy of the new material goes to John Whybrew.

JON CUNLIFFE  
Private Secretary



10 DOWNING STREET  
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*From the Private Secretary*

7 July 1986

**PRIME MINISTER'S MEETING WITH  
SIR EDWARD DU CANN**

Thank you for your letter of 7 July with the further briefing for the Prime Minister's meeting with Sir Edward du Cann. This was very helpful.

May I say for future occasions that it is often more helpful to the Prime Minister to have a pithy statement of the facts about a problem and a description of the Government's past policies than to have a line to take stated at length. She will of course welcome a proposed line to take but she is often familiar with that whereas the salient facts add the bite to the presentation of the Government's side of the discussion.

(David Norgrove)

Jonathan Cunliffe, Esq.



## PRIME MINISTER'S MEETING WITH SIR EDWARD DU CANN

### SUPPLEMENTARY NOTE

#### Decline of the Fleet and Aid to Shipping

It is entirely unrealistic, in the circumstances of gross over-supply of shipping and intense competition, to expect the British shipping industry to keep all its ships on the UK Register. Our system of taxation and of national insurance and the rates of pay and allowances that have been negotiated for our crews simply do not allow owners to compete in the deep-sea tanker and dry bulk fields in particular. The margin between operation on the UK and Bahamian flags, for instance, is up to £400,000 per vessel per annum.

There is no case for the tax payer subsidising this operation provided essential national interests can be safeguarded. The availability of vessels for the direct support of the armed forces is not currently a problem, though it may develop if the decline continues. Support for the civil population (ie supply of vessels to carry essential imports) gives more cause for concern. We have two basic ways of dealing with this:-

- i. NATO pooling (but will the pool be big enough? We are getting NATO to examine this).
- ii. Using flagged-out ships (but will the ships be manned by willing crews? The officers will be British if on Dependent Territory Registers - otherwise we will have to use seamen who have recently retired.)

Confidential : The Secretary of State for Transport is about to put to colleagues a plan for subsidising the use of vessels on certain Dependent Territory Registers as opposed to foreign registers, at modest cost to the taxpayer. The question of creating a Merchant Navy Reserve is also under consideration, on a slightly longer time-scale.



The problem is by no means peculiar to the UK. Other European fleets - Germany, Norway and Sweden for example - are much further down the road to operating under foreign flags.

Other European Governments - and the USA - do indeed give more help to their fleets. The industry was badly hit by the decision in the 1984 Budget to end the special capital tax regime for shipping investment and our failure to restore it - particularly 100% first year capital allowances - in subsequent budgets. But the Treasury argue that having rationalised the capital tax structure in 1984 it would be very dangerous to create a precedent by giving special treatment to shipping. And some concessions have been made:

- 1984 : 25% free depreciation in first year of acquisition of new ships, ie written off against any profits not just those from shipping operations (particularly helpful for large companies with a loss-making shipping subsidy).
- 1985 : 25% free depreciation in first year extended to acquisition of second-hand ships.
- 1986 : Business Expansion Scheme (BES expanded to cover ship chartering).

The GCBS want first year capital allowances restored, but we cannot create a precedent for this one industry.

**Confidential** : The Secretary of State is about to put to colleagues a scheme of investment grants for smaller vessels only, to match German and Dutch schemes.

European Community policy can help. In the course of our Presidency we propose to find ways of concluding a package which will give the EEC much more muscle in dealing with protectionism by other countries and which will resolve the cabotage (coastal trade) issue once and for all.



General protectionism is not the answer. Taken as a whole the greater part of UK shipping profits derive from cross-trading between foreign ports than from trade originating in the UK. General protectionsim, ie reserving UK trade for UK ships, would provoke retaliation which would badly damage our deep-sea operators.



## POINTS TO MAKE

### Defence Requirement

1. Generally have enough ships to meet direct defence needs. One or two specialised exceptions - we are looking at these.
2. Could mount a Falklands operation again : true some ships used in task-force no longer there and assembling fleet might take a little longer. But quite sure we could respond as effectively.
3. Should not look only at UK Register. All vessels flying UK flags (ie those on UK and UK dependent territory registers) can be requisitioned in time of war. For example, recent transfer of BP tanker fleet from UK to Bermudan register has not affected availability in time of war.
4. And ships not flying UK flag but beneficially owned in UK would probably be brought home by owners in time of war.

### Civil Resupply

5. More difficult issue. Depends on assumptions about duration of conflict.
6. In time of war, would be able to tap into pool of vessels of all NATO members for civil resupply purposes. Currently studying adequacy of NATO pool.

### Decline of the Fleet

8. Decline not as simple as it looks. Steepness of decline in recent years accentuated by artificial bulge in UK registrations during mid-1970's resulting from misguided Labour policies of subsidising UK register. These brought shipping not owned in UK onto UK register, much of which has left. Decline much less steep when compared to position in 1950s.



8. Decline a worldwide phenomenon. Brought about by over-supply which is result of bad decisions by bankers as well as subsidy and ship yards. Resulting over-capacity depresses rates and hurts shipping industry.

9. Different sectors affected in different ways. Much of decline in tonnage result of decline in tanker sector - effect of lower world oil usage.

#### Assistance to the Shipping Industry

10. John Moore looking at ways to ensure vessels available in times of tension and war and encouraging use and training of British officers and seamen. And have helped shipping in Budgets.

1984 - 25% first year allowance

1985 - extended to second-hand ships

1986 - BES to apply to ship chartering

11. But must be careful. Straightforward financial assistance would simply encourage over-supply - have seen the disastrous results of this course. Protectionism is not the answer. Our ship owners benefit more from cross-trading in others people's waters than from UK trading. Protectionism would invite retaliation and damage our industry.

12. Are working hard to liberalise EC cabotage: this will help our coastal and short sea operators. And close to agreement on EC package of retaliatory measures to counter protectionism by non-EC countries.



PRIME MINISTER'S MEETING WITH SIR EDWARD DU CANN

OBJECTIVES

To assure Mr de Cann that the state of both the merchant fleet and the shipbuilding industry are currently receiving close attention from Ministers.

To persuade him that the creation of a new Government department "to co-ordinate maritime affairs" is neither desirable nor practicable.

LINE TO TAKE

It is a mistake to conclude that the Transport Department is inactive over the state of merchant shipping. John Moore may be able to tell you something of what he is doing when you see him. But you will surely appreciate the difficulty of his task - of helping to arrest the decline while not contributing even further to the surplus of vessels.

There is already a high degree of co-ordination on maritime matters. On the war-time role of shipping for instance, Transport and Defence virtually operate as one. I am not sure that it would be in the general interest to reorganise Departments so as to brigade all our maritime functions together. Other problems would immediately appear - from the separation of shipping and civil aviation, for instance, and from the separation of responsibility for the marine equipment and other manufacturing industries.

There is indeed a problem over the availability of ships and men in war-time, and John Moore's work is directed particularly at dealing with this. But it is much more a question of whether we





and our NATO partners have the vessels to sustain the flow of essential imports into this country than whether we could, for instance, repeat the Falklands operation. On this last point, I agree that some of the vessels we used in the Task Force are no longer there, and a similar fleet could take a little longer to assemble but we are quite sure that if necessary we could respond with substantially the same effectiveness.

Department of Transport  
July 1986



PRIME MINISTER'S MEETING WITH SIR EDWARD DE CANN

BACKGROUND

Sir Edward asked to be allowed to bring his all-party Parliamentary Group to see the Prime Minister. The Prime Minister steered him in the direction of the Secretary of State for Transport but said that she would be prepared to see him (rather than his Group) after that meeting. He has asked to come before meeting Mr Moore.

2 Sir Edward's thesis is that the national interest requires a major injection of help to arrest the decline of the UK flag fleet, but apart from tax allowances he has not specified the means. He has usually rested on the contention that if the will is there, the means will be found, and his recipe for creating the will is to appoint a Minister to co-ordinate all maritime affairs in Government.

3 His main concerns are with the defence role of the merchant fleet ("we could not repeat the Falklands operation today"), with shipbuilding and with hydrography.

4 The Secretary of State for Transport is bringing to E(A) next week a paper containing two proposals for dealing with the problem of the declining fleet.

5 Copies of recent correspondence between the Prime Minister and Sir Edward are enclosed.

SHIPBUILDING

9.

Other shipbuilding countries

The UK shipbuilding industry is not alone in facing difficulties.

The Swedes have effectively abandoned merchant shipbuilding - despite having some of the most modern facilities in Europe. Ten years ago second world leader with 35,000 workers: now closing down industry altogether.

In Denmark two-thirds of shipyard jobs lost in 10 years.

The Dutch government refused to support their industry to build the sister ship to the large North Sea ferry won by Govan.

The Japanese are having to adjust to the shortage of orders. They have been cutting capacity since 1976, and are now considering a reduction of one third in the larger yards. That would entail over 20,000 job losses out of 60,000.

In South Korea job cuts of 7,000.

The Germans have cut their capacity by half since 1976 despite widespread use of soft credit to finance sales to developing countries.

The French are also cutting capacity. But the cost of maintaining their yards is reported to be very high. They do not at present have an aid regime agreed by the Commission. The Commission is, as with all Member States' aid regime, concerned to see that the level of support to the industry is matched by commitments to restructuring.

20 June 1986

KK7/17a

## International comparisons

In Japan job cuts likely to be 20,000 out of 60,000. In South Korea job cuts of 7,000.

### Sweden

Ten years ago second world leader with 35,000 workers: now closing down industry altogether. In Denmark two-thirds of shipyard jobs lost in 10 years.

### Labour Government record

- (i) Labour's support for shipbuilding amounted to £130 million compared with £1.5 billion since 1979.
- (ii) Labour had no answer to the problem of shrinking capacity. 20,000 job losses in merchant shipbuilding between 1974 and 1979.
- (iii) Labour policy of cancelling Trident would put 6,000 jobs in naval shipyards at risk.
- (iv) Problem of shipbuilding partly arises from excessive subsidy leading to excessive production. Labour policies are more of the same.

### Eric Varley quote

As Mr Varley, former Labour Minister said:

"The size of the industry ... depends ultimately on the ability of the industry to sell its product in world markets."

[Hansard 2nd December 1975, col 1448].

2nd June 1986

KK7/22

## SHIPBUILDING GENERALLY

### Points to make

- (i) Present state of shipbuilding industry not through lack of Government support - £1.5 billion since 1979.
- (ii) No point in scrap and build. Laid up tonnage is 40 million tonnes - more than twice world capacity to build of 18 million tonnes. In 1985 30 million tonnes of capacity was scrapped.
- (iii) No incentive for owners to build. Bulk cargo freight rates down one-quarter in last 10 years and tanker rates down by two-thirds.

*Better not to give examples - probably not suitable for Sunderland.*

(iv) [Public sector orders in prospect include fisheries protection vessel and Scottish ferry.] But public sector orders cannot be conjured out of thin air.

### Naval orders

This year Government will spend more than at any time in the last 20 years on production of ships and equipment for the Royal Navy. Currently 25 ships are on order, equivalent to £3½ billion. Since last June orders have been placed for:

- 2 Hunt class mine countermeasures vessels
- 1 Sandown class single role minehunter
- 1 Trafalgar class nuclear powered fleet submarine.
- 3 Upholder class diesel-electric patrol submarines.
- 1 auxiliary oiler replenishment vessel, and  
another announcement of 1 Trident submarine.

Value of these orders £1½ billion.

#9.

PRIME MINISTERS QUESTION TIME : 4 MARCH

BRIEF ON MERCHANT SHIPPING

## LINE TO TAKE

Changes in UK trading patterns and in world shipping conditions have led to the reduction in the British merchant fleet over the last decade. Some shipping sectors have been affected more seriously than others, and may continue to be so. But whilst I am aware of recent projections by the General Council of British Shipping, no official forecasts are made for the future size of the fleet. The Government continues to do all it sensibly can to help the retention of vessels by UK shipowners.

## BACKGROUND NOTE

## DECLINE OF FLEET

1 Fleet reduced by over 50% since 1975 peak, when exceptional fiscal conditions had encouraged expansion unsustainable in longer term. Decline brought about changes in UK trading patterns and in world shipping conditions. Our fleet is still 8th largest in world.

2 The UK fleet comprises various sectors operating in quite different markets. Some - passenger, ferries, and container - have held their own in difficult conditions; others are in areas in which we may continue to find it difficult to compete - eg tankers, which account for two-thirds of decline over the past decade.

3 Role fleet plays in support of defence and civil supply in time of emergency and war recognised, and subject to continuous planning and review.

## GOVERNMENT POLICY

4 As a major world trading nation, could not afford comparatively expensive shipping which would result if we took steps to avoid real competition.

5 Government's responsibility to ensure that real efforts towards adjustment being made by industry not thwarted by unfair competition. As a major cross-trading nation, best interests of fleet and seafarers lie in our policies designed to secure the widest and fairest world wide markets in which British shipping can compete. Hence our vigorous fight against protectionism, subsidy, non-commercial competition and unsafe vessels, in both international and cabotage trades.

6 So, we have reached agreement with West Germany on open cabotage; are pressing for progress on EC common shipping proposals; are seeking a wide international agreement including the USA on ways to stop protectionism and introduce reciprocal guarantees of complete access to trades; and are maintaining a high level of inspection of foreign vessels visiting UK ports.

## FLAGGING OUT

7 If companies decide to flag out to improve commercial viability, we cannot prevent this. Otherwise they might pull out of the business altogether, whereas flagging out retains some return to UK in remittance of profits and usually employment of seafarers. Have to remember substantial part of our fleet is foreign-owned.

## FISCAL

8 Within the wider scheme of tax reforms introduced in 1984, special attention has been given to the shipping industry. The industry has sought further special treatment in a submission to the Chancellor.

## GCBS PROJECTIONS

9 The General Council of British Shipping have recently projected that the end 1985 deadweight tonnage of the fleet will halve by either 1990 (worst case scenario) or 1995 (best case scenario). This realistically projects further significant reductions in tanker tonnage but does not take account of the current rate of increased scrapping, the fall in laid up tonnage and the potential spinoff effects of the current fall in oil prices - increasing demand for the transportation of crude and reducing operational costs. Nor does it take account of the growing importance of UK owned tonnage on other registries. Meaningful forecasts of future fleet size are very difficult to construct, and the Government does not attempt to do so.

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