

RESTRICTED

Parliament

NBPM



From the
Parliamentary Under Secretary of State

Mr Dwyer

DEPARTMENT OF TRADE
1 VICTORIA STREET
LONDON SW1H 0ET

TELEPHONE DIRECT LINE 01 215 3781
SWITCHBOARD 01 215 7877

To see &
return please

(I'm not copying to
you in case you are
not interested and
... of work).

Ms 27/11

Mr Schuler
A note decision. The intention
for Concorde is also cost-minimising.
I think we should have rights
to find the solution that best
meets it. (It's on the (EAT) agenda
for Monday.) No further comment.

26 November 1981 *27/11*

Norman Lamont Esq MP
Minister of State
Department of Industry
Ashdown House
123 Victoria Street
London SW1

Dear Norman,

CONCORDE FINANCES

I have seen a copy of your Private Secretary's letter of
20 November to Patrick Jenkin's Private Secretary.

I am content with the draft memorandum to the Select Committee
and proposed answer to the Parliamentary Question, broadly as
drafted. However, I know that a number of further suggestions have
been discussed between our officials since that draft was circulated;
and I assume these will be incorporated into the final version before
it is sent to the Select Committee.

I note what you say about the intended timetable for further
studies into the future of Concorde, leading up to the next Anglo-
French Ministerial meeting. I hope that it will be possible for this
proposed timetable to be adhered to, in a way which allows time for
full collective Ministerial consideration of the options for the
future of Concorde before the next Anglo-French Ministerial meeting.
Although the draft memorandum appears to show a big advantage in
continuation as against cancellation, the margin of error in the
forecasts is great and the economic balance of advantage between the
options is in fact less clear cut, particularly when the various
options of phased rundown are taken into account. In these
circumstances we need to satisfy ourselves that the course we follow
genuinely minimises calls on the PSBR by (among other things) offering
British Airways the best prospect of profitability.

RESTRICTED

RESTRICTED



I also think early Ministerial consideration of the options is important for another reason. Prolonged delay in reaching a decision on Concorde could well be the most damaging course of all. In particular, delay could be sufficient in itself to frustrate agreement between British Airways and Federal Express for the leasing of Concorde. Federal Express have requested that the Government commit itself by early next year to support Concorde. We must not, of course, let ourselves be hustled by such pressure into a premature and ill-considered decision; but the Federal Express contract would be a valuable one (not only to BA, but possibly also to Prestwick Airport and the surrounding Ayrshire economy) and it would be a great pity if it were lost simply through our indecision.

I hope therefore you will ensure that there is adequate time for full inter-Departmental consideration of the issues involved well before the next Anglo-French Ministerial meeting.

I am copying this letter to recipients of your Private Secretary's.

Yours ever,

A handwritten signature in dark ink, appearing to be 'Iain Sproat', written over a vertical line.

IAIN SPROAT

25 NOV 1981



RESTRICTED

CONFIDENTIAL



*From the
Minister of State*

Norman Lamont

Richard Riley Esq
Private Secretary to the
Secretary of State for Industry
Ashdown House
123 Victoria Street
London SW1

DEPARTMENT OF INDUSTRY
ASHDOWN HOUSE
123 VICTORIA STREET
LONDON SW1E 6RB
TELEPHONE DIRECT LINE 01-212 5902
SWITCHBOARD 01-212 7676

26 November 1981

Dear Richard,

CONCORDE FINANCES

Peter Mason wrote to you on 20 November enclosing the final draft of the memorandum which we hoped to lay before Parliament today and also of the proposed arranged written PQ and Answer.

Terry Mathews wrote on the Chief Secretary's behalf on 24 November asking for publication to be delayed until the matter had been discussed in E(EA). The item will, therefore, be taken at a meeting of the Committee on the morning of Monday 30 November.

In preparation for this meeting I enclose the Final Version of the memorandum and of the PQ and Answer, both dated 24 November. These incorporate the editing amendments to which the Department drew attention when submitting the final drafts for the Secretary of State's approval on 19 November.

I am copying this letter and attachments to recipients of Peter Mason's letter of 20 November.

*Yours ever,
Cecily*

CECILY MORGAN
Private Secretary

24 November 1981

CONCORDE

DRAFT ARRANGED WRITTEN PQ

To ask the Secretary of State for Industry, what action he has taken to reduce the incidence of the costs of Concorde to public funds, as recommended in the report of the Select Committee on Industry and Trade; when the results of the review of the relative costs to public funds of continuation and of cancellation of Government financial support for Concorde, referred to in the Government's reply, will be made available to Parliament; and what options are being considered in the joint studies on the future of Concorde commissioned by the British and French Governments on the occasion of the September Anglo-French Summit.

MR PATRICK JENKIN

In conjunction with the manufacturers, the Procurement Executive of the Ministry of Defence, who act as the Department's agents in the day to day technical and financial control related to the project, have undertaken a comprehensive examination of the support required for Concorde in present circumstances, and of project expenditures and receipts. The results of that examination, and of the review of the relative costs of continuation and of mutually agreed early cancellation, are set out in a memorandum by the Department of Industry which, in accordance with the Government's undertaking of last July, has today been placed in the Library of the House. Copies have also been sent to the Select Committee.

In a report to the Ministerial meeting between my hon Friend, the Minister of State for Industry (Mr Lamont), and the French Minister of Transport on 29 October British and French officials proposed that they should study three options on the future of Concorde, namely early cancellation (ie from 1 April 1982) mutually agreed, a phased rundown, and indefinite continuation.

The Ministers agreed that the first option need not be the subject of further joint study. The officials will therefore now consider the two remaining options, with a view to presenting a report on them to the two Governments early in 1982. As recorded in the Communique, of which a copy has been placed in the Library of the House, the Ministers have agreed to meet again in the first quarter of 1982 to reach conclusions on them.

I have accepted an invitation by the Select Committee to appear before them on 9 December to assist in their consideration of these matters. I shall be accompanied by my hon Friend, the Minister for Industry.

CONCORDE: REDUCTIONS IN COSTS TO PUBLIC FUNDS AND
REVIEW OF RELATIVE COSTS OF CONTINUING AND CANCELLING
GOVERNMENT SUPPORT

Memorandum by the Department of Industry

Introduction

1. In its reply of 14 July 1981 (Cmnd 8308) to the Second Report from the Industry and Trade Committee for the Session 1980-81 (HC 265) the Government:-

- (a) Indicated that it was already taking action, as described in the reply, in line with the Committee's first alternative for a reduction of the incidence of Concorde costs to public funds.
- (b) Stated that action will be continued across a broad front to achieve further reductions in public expenditures, and to increase Concorde project receipts.
- (c) Advised that the Department of Industry were currently reviewing comprehensively the relative costs of continuation and of mutually agreed cancellation of Government financial support for Concorde, as previously given to the Committee, to reflect changes in circumstances generally.
- (d) Undertook to make the results of this review known to Parliament.

2. The present memorandum accordingly:-

- (a) Describes, in paragraphs 7 to 11, the action taken over the past twelve months to reduce the incidence of Concorde costs to public funds, as in the first of the Committee's alternative recommendations.

- (b) Quantifies the expected overall financial results of such action, and compares current estimates of costs of in-service support with estimates, in respect of a generally higher level of in-service support activities, as given to the Committee earlier in 1981 (paragraph 9 and Table A).
- (c) Provides fresh projections by British Airways of their Concorde operating surpluses (which, in terms of the net costs of Concorde to public funds, form an offset to net project expenditures), and the airline's explanations of the basis of their calculations (paragraphs 16 to 20 and Table B).
- (d) Compares the estimated total cost to public funds so obtained (the costs of continuation) with the estimated costs of mutually agreed cancellation of financial support with effect from 1 April 1982 (paragraphs 12 to 31 and Table B). The reasons why 1 April 1982 was chosen for the purposes of the comparison are set out in paragraph 21.

Developments Affecting Concorde Calculations

3. The most recent comprehensive set of calculations relating to the Concorde project to be placed before Parliament were those contained in:-

- (a) The Department of Industry's memorandum of 3 March 1981 to the Select Committee, which contained summary estimates of Concorde project finances (Table D), and estimates of the relative costs to public funds of continuing British Government contracts for Concorde in-service support, and of cancelling them with effect from 1 October 1981 (Table E).
- (b) The Department's memorandum of 23 March 1981, which gave an analysis of Concorde project expenditures and

receipts by Financial Estimates forecast headings (Table F), and by British Aerospace and Rolls-Royce Production Brochure headings (Tables G to J).

4. Since then there have been a number of developments which affect the content and presentation of Concorde calculations, both in the present memorandum and in any subsequent exercise:-

- (a) On the occasion of the Anglo-French Summit of September 1981, the British and French Governments commissioned joint studies by British and French officials, as represented on the Concorde Management Board, on the future of Concorde (paragraphs 5 and 6 below).
- (b) The Government, having laid before Parliament Financial Estimates for 1981-82 calculated at 1981-82 forecast outturn prices, has now decided that Public Expenditure Survey (PES) calculations, as made for inclusion in the next Public Expenditure White Paper, shall be in cash (ie forecast outturn) terms, rather than at constant economic conditions, as previously (paragraph 33).
- (c) The comprehensive reassessment of Concorde support activities referred to in paragraph 1 (b) above, has now been completed, and the financial results expected from such reassessment evaluated (paragraphs 7 to 11 and Table A attached).

The implications of these changes are described below.

Anglo-French Studies on the Future of Concorde

5. This is the first occasion, since the project was inaugurated by Treaty between the two Governments in 1962, that joint British and French studies will have been undertaken that have, as one possible outcome, the termination of the project. At the Anglo-French Ministerial meeting on 29 October 1981 British and French officials proposed that their studies should cover three options, namely those of:-

- (a) Early cancellation, ie from 1 April 1982, mutually agreed This is the option for which British officials had been producing calculations in connection with the review of the relative costs of continuing and of cancelling British Government contracts for the in-service support of Concorde, as set out in the present memorandum. However, the Ministers decided that this matter need not be the subject of the joint studies.
- (b) A phased rundown As indicated below, this is capable of several meanings; and, for this and other reasons, it can best be evaluated on a joint Anglo-French basis. It has not therefore been the subject of previous studies by British officials, even on a hypothetical basis, in the same way as the two other options.
- (c) Indefinite continuation In the British context, this has been studied and reported upon on a number of occasions, including the present memorandum; and, in the Anglo-French context, as part of the cost sharing studies made by British and French officials (Annex E to Department of Industry's memorandum to the Select Committee of 6 October 1980, and paragraphs 4 and 5 of covering letter).

6. A phased rundown could be taken to mean:-

- (a) Only the cessation of Government financial support for their respective manufacturers to meet any losses in discharging the manufacturers' contractual obligations to their airline customers for Concorde in-service support (such financial underpinning being currently given by both Governments).
- (b) Or additionally the cancellation of financial support to meet losses incurred on Concorde airline operations (such support being given only in France).

- (c) Or, in addition to (a) and (b), that Concorde airline operations should cease in both countries. This is the meaning attached by the Select Committee who, in the second and alternative recommendation of their report, proposed that, depending on the results of a total reappraisal of current and future costs of operating Concorde, HMG should be ready to enter early discussions with all interested parties to ensure a speedy agreement to discontinue the operation of the aircraft at the earliest possible date, which the Committee hoped would occur no later than 1985. (Conclusion viii (b)).

The Ministers agreed that all three aspects should be studied.

Action Taken to Reduce Concorde Project Costs and to Increase Receipts

7. Concorde entered airline service with British Airways and Air France in January 1976. In the period to mid-1980 utilisation of the aircraft increased markedly. However, the manufacturers' support activities in both countries, past, present and future, were geared to support a much higher level of utilisation, both by the nine British Airways and Air France Concorde originally purchased, and also by the remaining five aircraft which the two Governments had decided in 1979 should be placed with the two airlines.

8. From mid-1980 onwards it became increasingly clear that, not only had airline utilisation peaked (at least temporarily), but that the level at which it had peaked was well below that which had been postulated when plans for in-service support were originally drawn up. Additionally, many of the support activities in the early in-service period, eg the post certificate of airworthiness development of the airframe and engines, the building up of stocks of spares, etc had been completed or had reduced to a stable and predictable programme to completion. The stage was thus set for a vigorous and wide ranging review of all aspects of support, their costs, and the receipts to which it was expected they would give rise.

9. The costed outcome of this review is summarised in Table A, which updates the estimates contained in Table D of the Department's memorandum of 3 March 1981. Over the five year period 1982-83 to 1986-87 this shows a reduction in estimated net expenditures of some £46 million (£82 million in project expenditures and £36 million in estimated receipts) compared with estimates made at the time of the earlier memorandum. Compared with the estimates shown in Table D, which covered only the three year period to 1984-85, a reduction in net expenditures of some £28 million is expected to take place. On a year-by-year basis, net expenditures are down by 33, 56 and 53 per cent for 1982-83, 1983-84 and 1984-85 respectively, and by even greater percentages for subsequent years.

10. The decrease in estimated expenditure is brought about by:-

- (a) Curtailment of the major fatigue and related programmes (an estimated £36 million of savings over the five year period). Such decrease was foreshadowed in paragraphs 5 and 6 of the Government's reply. The curtailment has since been recosted to enable budgetary provision to be made for a programme of much less costly testing. This entails only localised heating and cooling of certain parts of the major fatigue specimen, in place of the programme carried out hitherto, in which the entire specimen is heated and cooled. By concentrating the thermal aspects of the testing on those parts of the specimen that have hitherto been undertested, the new programme is expected to demonstrate an adequate fatigue life of the structure, and hence of the aircraft in service, at less cost than would have been the case had the existing, more comprehensive, programme been continued.
- (b) A scaling down of the engine spares provisioning programme, to reflect current expectations of a static level of utilisation of British Airways Concorde and a reduced level of Air France operations, as well as increased operating lives of key engine components,

and the ability, in many instances, to draw upon substantial stocks which have resulted from earlier manufacturing programmes (an estimated £7 million).

- (c) A corresponding scaling down of airframe spares production, occasioned mainly by the fact that production of spares and other support items for sale to independent Concorde operators is no longer required now that the two remaining British assembled Concordees have been placed with British Airways, and the three French aircraft with Air France (£5 million).
- (d) The restriction of the engine in-service support programme (formerly in-service development) to that required for the maintenance of airworthiness and reduction of warranty expenditures (£9 million). This restriction was foreshadowed in paragraph 45 of the Department's memorandum of 6 October 1980, and is being progressively and rapidly implemented.
- (e) Reductions in funding required for Rolls-Royce work in progress in the production of engine spare parts (£5 million).
- (f) Reduced costs of insurance £4 million).
- (g) Reduced amounts of VAT payable on the lower level of engine in-service support expenditures £3 million).
- (h) A package of lesser measures, arising out of a comprehensive search for economies in in-service support conducted jointly with French officials and the manufacturers in both countries, and announced on the occasion of the 29 October 1981 Ministerial meeting (£9 million).
- (i) A residual £4 million in respect of reductions in a wide range of other items.

11. The changes in estimated receipts are due to:-

- (a) A reduction in estimated receipts from the sale of engine spares, the result of a reappraisal of the requirements of British Airways and Air France in the changed circumstances described in paragraph 10(b) above (£16 million).
- (b) An offsetting £6 million arising from a weighted average 13 per cent increase in the real price of Rolls-Royce Olympus 593 spares from 1 February 1982, and the structuring of future spares catalogues to maintain the higher margins so achieved. This increase has been proposed in line with the Government's general policy of reducing the incidence of the costs of Concorde to public funds, by reducing expenditures and increasing receipts.
- (c) A reduction of £17 million in the estimated receipts from the sale of airframe spares, the counterpart of the reassessment of airframe spares production requirements referred to in paragraph 10(c) above.
- (d) The elimination of an estimated £6 million of receipts in 1982-83 from compensation for the loss of airframe spares. This is because a full and final settlement of the claim is now expected in 1981-82.
- (e) A residual £3 million decrease in respect of other items.

The Estimated Costs of Continuation and of Cancellation

12. Table B sets out the Department's estimates of the relative costs to public funds of continuation and of cancellation on 1 April 1982 of British Government contracts for Concorde in-service support. The Table is similar in format to Table E of the Department's memorandum of 3 March 1981, but with the following changes:-

- (a) The figures are expressed at September 1981 economic

conditions, instead of September 1980 conditions.

- (b) The estimates cover a five year period commencing on 1 April 1982 (the now earliest date assumed feasible for mutually agreed cancellation - see paragraph 21), instead of a three and a half year period commencing 1 October 1981. Within this period the figures are now analysed according to financial years.
- (c) To compare the results with the estimates furnished in March 1981, totals for the latter figures, adjusted and extended as necessary, have been added at the bottom row of Table B.

For the five year period 1982-83 to 1986-87 Table B shows that the estimated net costs of continuation are £6 million, which is some £28 million less than the estimated net costs of cancellation. The Table also shows that, at the time of the earlier memorandum, the estimated costs of continuation at £57 million were greater than the cancellation costs by some £9 million. The main features of each column of figures are set out below.

Net Project Expenditures

13. Table B figures are derived from the estimates in the last column of Table A. The figures have been established in accordance with the procedures described in paragraph 4 of the Department's memorandum of 23 March 1981, and reflect the latest annual returns provided by British Aerospace and Rolls-Royce.

14. In accordance with Government accounting conventions, contingent items are excluded from both expenditures and receipts. Most of the items set out in the Annex to the Department's memorandum of 3 March 1981 have since become sufficiently firm for the relevant amounts to be included in the present estimates. The remaining contingent items are now confined to the following:-

- (a) Potential additional receipts from the sale of airframe spares, should there be a real increase in prices similar to that in course of implementation for engine

spares (paragraph 9 of the Annex, and paragraph 11(b) above). A decision on this is not due to be taken until fairly well into 1982.

- (b) Additional receipts should the eventual settlement of negotiations for compensation for the loss of airframe spares (as referred to in paragraph 12 of the Annex) result in a payment being received in 1982-83 or subsequently, contrary to the expectations held out in paragraph 11(d) above that a full and final settlement of the claim is now likely in 1981-82. The amount of such receipts would depend upon the outcome of the negotiations for a settlement in the current financial year, which are still in progress, and cannot therefore be quantified.
- (c) Additional expenditures arising from the need to give in-service support to a possible transatlantic parcels service by Federal Express using leased Concorde, and additional receipts resulting from the sale of airframe and engine spares and other support items for such a service. This contingent item has arisen since the March 1981 list was compiled. The amounts and timing of such expenditures and receipts, and whether they take place at all, will depend upon the outcome of negotiations currently in hand between the carriers concerned. It has been agreed that they shall be evaluated in the context of the Anglo-French studies referred to in paragraphs 5 and 6 above.

15. Contingent items relate only to foreseen events. It follows that, during the period covered by these estimates, there could arise other items which, not being currently foreseeable, could result in changes of expenditures or receipts over and above those included in Table A or referred to in paragraph 14 above.

British Airways Operating Results

16. As with previous submissions, the figures for the British

Airways Concorde operating results are based on estimates provided by British Airways themselves, and for which the airline therefore take responsibility. To the extent that they reduce British Airways' potential borrowing requirements, they represent a reduction in the Public Sector Borrowing Requirements (PSBR) and hence of the costs of Concorde to public funds (footnote (4) to Table B). The only adjustment the Department have made to the airline's estimates is to add an allowance to the airline's projected expenditures, and consequently to reduce their forecast operating surpluses, to cover the increase in the real price of Rolls - Royce engine spares, as referred to in paragraph 11(b) above and in footnote (4) to Table B.

17. British Airways have not prepared detailed estimates of Concorde operating results beyond 1983-84. They consider it to be a reasonable basis for estimation, however, to continue their forecast 1983-84 operating surplus into later years so as to enable the Department to present a comprehensive assessment of the total costs of continuation at constant September 1981 economic conditions over a five year period. Table B has therefore been drawn up on this basis.

18. As a result of their latest review British Airways' forecast operating surpluses are now somewhat larger than in the calculations presented last March. The increases reflect the following British Airways assumptions:-

- (a) Concorde services, now confined to New York and Washington, continue on these routes only, no allowance being made for any new services or for the lease of aircraft to Federal Express for a possible transatlantic parcels operation (on which see paragraph 20).
- (b) Passenger numbers reflect a decline in the total market in 1981-82, relative to the previous twelve months, of 10 per cent, followed by nil growth in 1982-83, and by 2 per cent per annum growth thereafter. However, retimings and additional frequencies from

October 1981 are assumed to contribute once and for all increases in passenger numbers of 31 percent in Winter 1981-82, and of 10 percent in Summer 1982, on the New York route; and of 17 percent in Winter 1981-82, and 3½ percent in Summer 1982, on the Washington route. After allowing for the 10 percent decline in the total market, the percentage increases in Winter 1981-82 for the New York and Washington routes consequently come out at 21 and 7 percent respectively, these being the percentages actually used in calculating the estimated number of passengers during that period, and hence the total revenue yield. The sensitivity of the calculations to the foregoing assumptions is indicated in paragraph 19 below.

- (c) Except where there are abnormally sharp movements (which may impose a temporary time lag), increases in the cost of bought in supplies, particularly fuel and oil, can be passed on in the shape of higher fares without significant loss of revenues.
- (d) Cost increases under British Airways' direct control, mainly wages, salaries and overheads, will be limited in line with the airline's general policies of cutting costs and improving its productivity in response to current financial challenges.
- (e) The benefits of reduced costs and improved productivity arising under (d) above, when coupled with a sustained level of revenue yields, will produce higher operating margins and increased operating surpluses above expected 1981-82 levels.

19. As will be apparent from the year by year comparisons of net project expenditures and British Airways surpluses, as shown in Table B, the net total costs to public funds of continuation are sensitive to whether or not the airline's Concorde operating results turn out as forecast. In order therefore to test the sensitivity of the airline's Concorde results to changes in

traffic forecasts, and thus the sensitivity of the total net continuation costs, British Airways have, at the Department's request, assessed the effect of removing from their calculations the benefit of the improved frequencies and retimings. British Airways estimate that this would reduce their forecast operating surplus by some £3.5 million in 1982-83, and by an equivalent amount at constant September 1981 economic conditions in each subsequent year, making a total reduction of £17.5 million over the five year period 1982-83 to 1986-87. These projections, and their sensitivities, will fall to be reassessed in early 1982 in the context of the Anglo-French studies referred to in paragraphs 5 and 6 above, when some experience will have been gained of the initial impact of the new schedules and frequencies on passenger numbers.

20. British Airways' projected operating surpluses are also susceptible to adjustment in an upward direction, should the current negotiations with Federal Express due for completion by April 1982 lead to the lease of Concorde for a transatlantic parcel service, and to a contract for their maintenance. For this reason it has been agreed that the Anglo-French studies should not only evaluate Concorde finances (as does the present memorandum) on the basis of continuation without a possible Federal Express operation, but also take account of the implication of such an operation.

Contractual Costs of Cancellation

21. These are mainly the costs that would be incurred by the Government in invoking the standard three months break clause in its contracts with British Aerospace and Rolls-Royce, less receipts from the manufacturers during that period. They are therefore sensitive to the date on which it is assumed that formal notice of termination of their contracts with HMG is given to the manufacturers. Thus, because the calculations assume mutually agreed cancellation to be implemented with effect from 1 April 1982, instead of from 1 October 1981 as previously, they now exclude both the £11 million of airframe spares compensation stage payment postulated to fall due in the financial year 1981-82, and

the £6 million of former 1982-83 receipts referred to in paragraph 11(d) above which are now assumed to fall due in 1981-82. This in turn results in the balance between payments and receipts now showing a substantial net payment by HMG to the manufacturers in the event of cancellation, compared with the net receipts by HMG from the manufacturers shown in the March 1981 calculations. The date of 1 April 1982 represents an agreed assessment by British and French officials of the earliest date by which formal notice of termination of contracts could have been given, had the Ministers at their meeting on 29 October 1981 decided to begin negotiations between the two Governments, the two British and two French manufacturers, and the two national airlines, for early cancellation by mutual agreement between all the parties concerned, and to a mutually agreed timescale. It is also assumed, when making the calculations that, until formal notice of termination of contracts is given to the manufacturers, the tasks designated under the contracts continue to be performed and to be paid for, and that Concorde airline operations, and hence the need for support and manufacturers' and Government revenues from support, also continue.

Severance Costs of Cancellation

22. These are derived by taking the number of jobs lost as a result of cancellation of the Government's contracts with the manufacturers, and by the consequent cessation of Concorde airline operations, as assessed by the employers in question, multiplied by each employer's assessment of the average amount of severance pay that would need to be given in respect of each employee leaving under a voluntary redundancy scheme. Such amounts would be met partly out of receipts from the statutory Redundancy Fund. The balance would be met:-

- (a) In the case of British Aerospace and Rolls-Royce, by payments made by MOD (PE) under their contracts with the manufacturers. Severance payments at the rates assumed by these firms would be in accordance with established MOD (PE) practice in implementing the standard cancellation provisions as applying to Government contracts generally.

- (b) In the case of those sub-contractors and suppliers to Rolls-Royce who have a contractual relationship with the manufacturer of a kind that could entitle them to have severance payments to their employees met out of the Department's Concorde Vote, by payments made by MOD (PE) of a similar amount per employee to that assumed for Rolls-Royce. There are no such sub-contractors and suppliers to British Aerospace.
- (c) In the case of British Airways, there being no specific contracts between the Government and the airline which would cover severance payments, by payments out of the airline's general funds. In current circumstances this would add to the airline's borrowing requirement, and hence to the Public Sector Borrowing Requirement.

Table B shows the total amount of all severance payments, however arising.

23. The reduction in total estimated severance payments compared with the figures included in the March 1981 calculations, as shown on Table B, results from substantially smaller total numbers (an estimated 1,700 compared with some 3,200) now considered to be employed on Concorde at the later date now assumed for cancellation, namely 1 April 1982. As against this, as was foreshadowed in paragraph 9(d) of the Government's reply to the Select Committee's report, there is no longer scope to transfer labour at British Aerospace and Rolls-Royce to defence contracts. The assumptions included in the present calculations as to redeployment possibilities, and how they compare with those assumed for the purposes of the March 1981 calculations, are therefore that:-

- (a) In the case of British Aerospace, any job losses arising out of Concorde cancellation would have to be met by a corresponding reduction in the firm's total workforce, and could not be partially offset by redeployment within the firm, for which an allowance of 25 per cent of total numbers was included in the previous calculations.

- (b) In the case of Rolls-Royce, some 15 per cent of Concorde workers would be retained, compared with 25 per cent assumed for the previous calculations, and would in due time fill expected future vacancies.
- (c) In the case of Rolls-Royce's suppliers and sub-contractors, any job losses arising out of Concorde cancellation would have to be met by a corresponding reduction in their total workforce (a similar assumption was made previously).
- (d) In the case of the Royal Aircraft Establishment, Farnborough, the relatively small numbers made surplus by cancellation of Concorde contracts could be reabsorbed in full within the organisation.
- (e) In the case of British Airways, reflecting the airline's general moves to reduce manning, any job losses arising out of Concorde cancellation would have to be met by a corresponding reduction in the airline's total workforce over and above the reduction envisaged by current manning policies (a similar assumption was made previously, though not in the context of current general moves to reduce manning).

24. The calculations are statistically sensitive to the following factors:-

- (a) For purposes of calculation only, it is assumed that, given the relatively small numbers now involved, any reductions in the workforce of the employer concerned as a result of cancellation of Concorde contracts would be brought about by a voluntary redundancy scheme, and not by compulsory severance. Under such a scheme the employees leaving would not necessarily be those formerly employed Concorde. However, for the purposes of calculating the average amount of severance pay, it is assumed that the age, sex and skill profiles of those leaving would be similar to that of the existing Concorde labour force (including, where appropriate, indirect as well as

direct employees). This assumption is in turn used when calculating the other PSBR costs of cancellation, as referred to in paragraphs 25 to 31 below. A different profile of actual jobs lost could produce different results; the difference could be either positive or negative depending upon the amount by which such profiles differed from the Concorde employee profile, and the direction of such differences.

- (b) In the case of British Aerospace and Rolls-Royce (whose combined Concorde employment accounts for about two thirds of the figure of 1,700 referred to in paragraph 23 above), it has been possible to include an allowance for employees not specifically allocated to Concorde, as well as direct employees, when calculating the number of jobs lost through cancelling contracts. However, in the case of British Airways, it has been possible to take account only of direct employees, ie those employees who are clearly identifiable with Concorde operations. To that extent the severance costs to British Airways associated with cessation of Concorde operations on 1 April 1982 are understated, as are the other PSBR costs of cancellation.

Other PSBR Costs of Cancellation

25. These consist of additional Exchequer costs payable in Unemployment Benefit, including Earnings Related Supplement, and revenue losses from direct taxation and National Insurance contributions. They assume that the number of jobs lost is as described in paragraph 23 above, less an allowance for jobs that would be lost even if the project continued, but including an allowance for jobs lost at vendors, ie firms supplying directly to the airlines, for whom no requirement therefore exists to meet severance payments out of public funds.

26. The figures depend upon the speed with which the workers

made redundant as a result of cancellation find other jobs. The characteristics of the existing Concorde workforce, and the evidence of a number of redundancy studies, suggest that the ex-Concorde workers (or their equivalents under a voluntary severance scheme) would find work relatively quickly. However, it is much harder to predict the extent that their re-employment would displace other unemployed people who would otherwise have found employment. The calculations in Table B have used a faster rate for net re-employment of the displaced workers (assuming no displacement of other job seekers) than was used in previous calculations. Thus they assume that 25 percent of those discharged find work by the end of the three months rundown period for Government contracts referred to in paragraph 21 above, ie on 1 July 1982; that jobs are created for a further 25 percent at the end of 1982-83; for a further 25 percent at the end of 1983-84; and a further 25 percent at the end of 1984-85 (by which time all those losing their jobs as a result of Concorde cancellation are assumed to be reabsorbed).

27. This new assumption, which is one of a possible range, partly reflects more detailed information about the composition of the Concorde labour force than was available when the previous estimate were made, and about job opportunities in the areas where the redundancies would occur. It also gives greater weight to more general factors affecting the speed of labour market adjustment.

28. Concorde cancellation would increase unemployment for a period in the local area concerned. But it is the impact on national employment levels of that decision that is much more difficult to assess. In the long run the level of national unemployment will depend on a number of factors, but will be unaffected by individual closure decisions. However, over the shorter period being considered here, a decision to cancel Concorde would lead to some increase in overall national, as well as local, unemployment above its underlying long run level.

29. Reflecting the new assumptions about the rate of job creation set out in paragraph 26 above, the current estimates of other

PSBR costs, as shown in Table B, are less than one third of the March 1981 estimates. It is therefore worthwhile measuring the sensitivity of the calculations to the changed assumptions. In this connection the effect of the new assumed rate of job creation can best be judged by estimating what other PSBR costs would be on the new job loss figures, but at the previous assumed rate of job creation. This calculation would increase the other PSBR costs from the £10.4 million shown in Table B to £18.3 million. This is still little more than half the March 1981 estimates, but is in line with the reduction of the assumed Concorde workforce, as indicated in paragraph 23 above, of whom a rather greater proportion would now stand to be added to the numbers of job seekers in the event of cancellation than was the case with calculations made earlier this year.

30. In practice another important consideration affecting unemployment levels would be the way in which a cancellation decision might be announced. Sudden closure without warning is much more likely to result in longer periods of higher unemployment than if a longer period of notice is given, because the discharged workers would all be thrown onto the labour market at once. The assumption of a 25 percent re-employment within three months of termination of the project is unlikely to be consistent with an unexpected and sudden decision to cancel. It would, however, be consistent with a decision of the Anglo-French Ministerial meeting on 29 October 1981 to propose for consideration by the parties concerned cancellation with effect from 1 April 1982, had such a decision been taken. On the other hand, a decision taken at some time in the future to cancel giving longer notice than this would, by spreading out Concorde redundancies, reduce the PSBR costs of unemployment from cancellation below those calculated in Table B.

31. Overall there has been a very considerable reduction in the estimated PSBR costs of cancellation compared with the previous calculations. This reflects:-

- (a) A sharp reduction in the numbers taken to be employed on Concorde at the time of cancellation since the last set of calculations was made.

- (b) More detailed information about the composition of the Concorde labour force, and about job opportunities in areas where the redundancies would occur.
- (c) An assumed more rapid rate of job creation, both for reasons specific to Concorde and as a result of giving greater weight to general factors affecting the speed of labour market adjustment.

Other Considerations

32. The estimates in Tables A and B, and the figures of the preceding paragraphs, are all at constant September 1981 economic conditions. There are, however, other ways of measuring the incidence of Concorde expenditures and receipts, of which the following are the most important.

(a) Forecasts in Cash Terms

33. As indicated in paragraph 4(b) above, forecasts of public expenditure are in future to be presented to Parliament in cash, ie forecast outturn, terms rather than at constant prices. This will make it easier for Parliament, both generally and in respect of individual programmes such as Concorde, to assess the likely impact on the level of public expenditures and revenues. At present, however, such estimates cannot be made for Concorde beyond 1983-84 for all the items listed in Table B; and, even for earlier years, definitive figures are not, as yet, available.

(b) Discounted Figures

34. The net costs to public funds of mutually agreed cancellation are estimated to be £34 million for the five year period reviewed, and compare with net costs over the same period for continuation of £6 million. Discounting both revenue and costs would take account of the value placed on money at different points in time, but would, in this case, have a negligible effect on the relative cost of continuation and cancellation, and therefore has not been presented.

(c) Resource Costs and Transfer Payments

35. The cost figures presented here may be viewed in principle either as cash flows between the Exchequer and the private sector or, in the case of cost items in the continuation option, they can equally be viewed as resource costs which measure the total loss of income to society. It is arguable that the cost of contractual payments in the case of cancellation can also be seen as a resource cost. The other cancellation costs (redundancy costs and the loss of tax receipts plus higher unemployment payments) are transfer payments between individuals, and consequently do not represent a loss of national income. They do, however, represent additional public expenditures which, if they are incurred, can only be met by corresponding reductions elsewhere in public expenditures, or by higher taxes, or by increased borrowing.

Conclusion

36. In its reply to the Select Committee's report the Government noted that there were substantial opportunities for bringing down the total costs of continued Government financial support for Concorde, and stated that action will be continued across a broad front to achieve further reductions in public expenditures, and to increase Concorde receipts.

37. The results of this action are set out in paragraphs 7 to 11 above, and in Table A. The latter indicates that estimated net project expenditures for the three years 1982-83 to 1984-85 show reductions of 33, 56 and 53 percent respectively on the previous corresponding figures; even more substantial reductions are forecast for the two subsequent years for which calculations are now presented.

38. The Government's reply also indicated that additionally the Department of Industry were currently reviewing comprehensively the relative costs of continuation and of cancellation, as previously given to the Committee, to reflect changes in circumstances generally. The results of this action are set out

in paragraphs 12 to 35 above, and in Table B. The latter indicates that, for the five year period 1982-83 to 1986-87 now adopted, the estimated costs of mutually agreed cancellation, at some £34 million, are considerably higher than the net cost of continuation, at some £6 million.

39. In presenting this comparison the Department note that this memorandum provides, on the one hand estimates of the costs to public funds of continuing Government financial support for Concorde under existing contracts between the Government and British manufacturers, and on the other hand the estimated cost to public funds of mutually agreed cancellation of Government financial support for Concorde with effect from 1 April 1982 by termination of these contracts. This comparison follows the lines of earlier evidence to the Select Committee. But the Department recognise that the choice of action would not necessarily lie simply between early cancellation, ie from 1 April 1982, of support, or indefinite availability of support. There is also, as noted in paragraphs 5 and 6, the possibility of a phased rundown of Government support, which would have different public expenditure implications. The various aspects of a phased rundown are being studied by British and French officials with a view to their reporting on this option, and on that of indefinite continuation, to the two Governments early in 1982.

40. The estimates in this memorandum and its tables represent the best assessments that can be made today of the costs to public funds of continued Government financial support of Concorde, and of how this relates to the costs of early cancellation. As was the case with previous forecasts, great care has been taken to avoid bias in these calculations; and contingent items, which on balance would have a favourable impact on Government expenditure and revenues, have been excluded from the calculations. As indicated above, the individual items which go to make up these estimates are, however, subject to varying degrees of statistical sensitivity, depending upon the fulfilment or non-fulfilment of the assumptions on which the calculations are based; and new events may further alter the figures. Therefore it remains the case that, as noted in the Government's reply to the Select

Committee's report, frequent adjustment of figures must be expected with any programme, such as the Concorde programme, which is undergoing rapid change. However, where adjustments have been made, the reasons have been given; and attention has been drawn wherever possible to adjustments which may be required in the future.

Department of Industry

[] December 1981

TABLE A: CONCORDE PROJECT FINANCES

£ million
at constant September 1980
economic conditions

Year	JANUARY 1981 FORECASTS			MARCH 1981 FORECASTS			PRESENT FORECASTS		
	Expend- itures	Receipts	Net Expend- itures	Expend- itures	Receipts	Net Expend- itures	Expend- itures	Receipts	Net Expend- itures
1982/83	50.7	22.6	28.1	52.0	25.9	26.1	31.1	13.5	17.6
1983/84	46.1	23.8	22.3	40.7	20.0	20.7	21.3	12.2	9.1
1984/85	45.0	24.2	20.8	33.1	18.5	14.6	18.8	12.0	6.8
Total 1982/83- 1984/85	141.8	70.6	71.2	125.8	64.4	61.4	71.2	37.7	33.5
1985/86	NA	NA	NA	30.4	16.5	13.9	15.5	12.0	3.5
1986/87	NA	NA	NA	28.0	16.7	11.3	15.7	11.8	3.9
Total 1982/83- 1986/87	NA	NA	NA	184.2	97.6	86.6	102.4	61.5	40.9

- NOTES: (1) Basis of forecasts This table updates forecasts of Concorde project expenditures and receipts, as given to the Select Committee on Industry and Trade by the Department of Industry on 3 March 1981 and reproduced by the Committee at page 106 of the Committee's Minutes of Evidence. They represent the Department's best estimates of the costs of carrying out agreed Concorde tasks, and of receipts therefrom.
- (2) Economic conditions All figures are at September 1981 economic conditions.
- (3) Concorde Vote items The present forecasts (unlike those in Table D of the Department's memorandum of 3 March 1981) take account of forecast receipts from capital assistance rentals of some £0.3 million annually. Since the previous forecasts were presented these receipts have been reclassified by Treasury as a Public Expenditure Survey (PES) item.
- (4) Contingent items In accordance with Government accounting conventions contingent items, as set out in paragraph 14 of the memorandum, are excluded from both expenditures and receipts.
- (5) January 1981 forecasts The estimates are as given in Table C of the Department's memorandum of 27 January 1981 (and subsequently in Table D of the memorandum of 3 March 1981), revalued to September 1981 economic conditions.
- (6) March 1981 forecasts The estimates are as given in Table D of the Department's memorandum of 3 March 1981, revalued to September 1981 economic conditions.
- (7) Figures for 1985-86 and 1986-87 The January 1981 and March 1981 forecasts, as included respectively in the Department's memorandum of 27 January and 3 March 1981, covered the period to 1984-85. In the latter case, calculations for 1985-86 and 1986-87 were, however, also made for project planning purposes, but were not included in the 3 March 1981 memorandum. To give a basis of comparison between previous and present forecasts, both in this table and in Table B (which likewise covers a five year period), they are now included, revalued to September 1981 economic conditions.
- (8) NA: Not available

TABLE B - RELATIVE COSTS TO PUBLIC FUNDS OF CONTINUING AND CANCELLING
BRITISH GOVERNMENT CONTRACTS FOR CONCORDE IN-SERVICE SUPPORT

£ million
at constant September 1981
economic conditions

Period	Costs of Continuation			Costs of Cancellation			
Financial Year	Net Project Expenditures	British Airways' Surpluses	Net Total	Contractual Costs/Receipts(+)	Severance Costs	Other PSBR Costs/Savings (+)	Net Total
1982-83	17.6	(+) 5.4	12.2	12.2	14.5	5.5	30.4
1983-84	9.1	(+) 7.4	1.7	(+) 0.3	Nil	4.0	3.7
1984-85	6.8	(+) 7.4	(+)0.6	(+) 0.3	Nil	1.9	1.6
1985-86	3.5	(+) 7.4	(+)3.9	(+) 0.3	Nil	(+) 0.5	(+)0.8
1986-87	3.9	(+) 7.4	(+)3.5	(+) 0.2	Nil	(+) 0.5	(+)0.7
	<hr/>	<hr/>	<hr/>	<hr/>	<hr/>	<hr/>	<hr/>
PRESENT TOTALS	40.9	(+)35.0	5.9	9.3	14.5	10.4	34.2
PREVIOUS TOTALS	85.0	(+)28.3	56.7	(+) 8.2	19.8	35.9	47.5

- NOTES: (1) Basis of forecasts This table revises the estimates given by the Department of Industry to the Select Committee on Industry and Trade on 3 March 1981, and reproduced at page 107 of the Committee's Minutes of Evidence. Estimates for two further years, 1985-86 and 1986-87, have been added; and estimates are now expressed on an updated price basis (September 1981 instead of September 1980).
- (2) All figures are at September 1981 economic conditions, and except where indicated by a (+) sign represent a cost to public funds.
- (3) Net project expenditures are for total costs to public funds, as met out of the Department of Industry's Concorde Vote. Thus they comprise expenditures less receipts as shown in Table A.
- (4) British Airways surpluses are as estimated by the airline, less £0.5 million for each year to allow for a real increase in the price of Rolls-Royce Olympus 593 engine spares. They represent savings in the amount of the Government's Public Sector Borrowing Requirement (PSBR), and as such are deducted to arrive at a net total of the cost to public funds of continued Government financial support for Concorde.
- (5) Contractual costs of cancellation assume mutually agreed cancellation with effect from 1 April 1982. In 1982-83 they are net of receipts from the manufacturers during the three month break period of the contracts. They also include outstanding payments by British Aerospace under the Simulator Operating Agreement. For each year they reflect continuing income from capital assistance item rentals, which are also taken into account in the costs of continuation.
- (6) Severance costs as shown include all severance payments. Thus payments met by HMG under its contracts with British Aerospace and Rolls-Royce in respect of their discharged employees, as well as any settlements by Rolls-Royce when terminating contracts with suppliers and subcontractors in respect of employees discharged by such suppliers and sub-contractors (estimated at £1 million), are included in this column and not under the contractual costs of cancellation. Similarly redundancy payments arising in other ways, eg out of the statutory Redundancy Fund, or by British Airways in respect of their own employees, are included in this column, and not as other PSBR costs.
- (7) Other PSBR costs The savings shown for 1985-86 and 1986-87 arise because certain of the employees assumed to be made redundant in 1982 are, if the project continues, also assumed to have ceased working on Concorde between 1983 and 1987. Thus making them redundant in 1982 results in jobs being recreated earlier than in the case of continuation, leading to savings in PSBR costs towards the end of the five year period.

- (8) Previous totals are those in Table E of the Department of Industry's memorandum of 3 March 1981, adjusted to allow for the postponement of the assumed date of mutually agreed cancellation from 1 October 1981 to 1 April 1982, the extension of the calculations to include estimates for 1985-86 and 1986-87, and the revaluation of the figures from September 1980 to September 1981 economic conditions. Explanations for the principal reasons for the differences between the two sets of estimates are given in the text.

CONFIDENTIAL



Foreign and Commonwealth Office

London SW1A 2AH

26 November 1981

Dear Peter

CONCORDE FINANCES

Thank you for copying to me your letter of 20 November to Richard Riley, enclosing a memorandum on Concorde for presentation to Parliament and a draft inspired PQ.

We understand that the Chief Secretary has now suggested that the memorandum should be discussed at a meeting of E(EA), and that this has been fixed for Monday 30 November. The Lord Privy Seal will be attending the meeting, and will put his views then.

I am copying this letter to the recipients of yours.

Yours ever

M A Arthur

M A Arthur
PS/Lord Privy Seal

P E Mason Esq
PS/Minister of State
Dept of Industry
Ashdown House
LONDON SW1E 6RB

CONFIDENTIAL

CONFIDENTIAL



Treasury Chambers, Parliament Street, SW1P 3AG

Peter Mason Esq
Private Secretary to the
Rt Hon Patrick Jenkin MP
Secretary of State
Department of Industry
Ashdown House
123 Victoria Street
London SW1E 6RB

24 November 1981

Dear Peter,

CONCORDE FINANCES

The Chief Secretary has seen the letter of 20 November from Mr Lamont's Private Secretary to you attaching a proposed arranged written PQ and answer and a draft memorandum about Concorde, which it is proposed to lay before Parliament. He realises that you are now up against a tight deadline from the Select Committee but feels that the issue is of sufficient importance to warrant collective Ministerial discussion before Government policy is decided and promulgated. He has therefore asked that publication should be delayed until the matter has been discussed in E(EA).

I am copying this letter to the Private Secretaries to the Prime Minister, all members of E(EA), the Lord President, the Lord Privy Seal, the Chancellor of the Duchy of Lancaster, the Chief Whip and the Minister of State for Defence Procurement, and to David Wright (Cabinet Office).

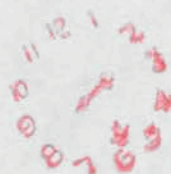
Yours ever
Terry Mathews

T F MATHEWS

Private Secretary

CONFIDENTIAL

25 NOV 1981



CONFIDENTIAL



DEPARTMENT OF INDUSTRY
ASHDOWN HOUSE
123 VICTORIA STREET
LONDON SW1E 6RB

TELEPHONE DIRECT LINE 01-212 5902
SWITCHBOARD 01-212 7676

From the
Minister of State

PS/Norman Lamont MP

Richard Riley Esq
Private Secretary to the
Secretary of State
Department of Industry
Ashdown House
123 Victoria Street
London SW1

PS/Sec of State

PS/Mr Wakeham

PS/Secretary

Mr Croft

Mr Hudson

Mr Treadgold

Mr Dickson

Mr Chapman

Mr Atkinson

Mr Cumming

Miss Wallace

Mr Hardbattle

Mr Stredder

Mr Novell

Mr MacTavish

(with papers)

20th November 1981

Alan Richard

CONCORDE FINANCES

My Minister thinks his colleagues on E(EA) will wish to be aware of the background to the memorandum which it is proposed should be laid before Parliament next Wednesday, 25 November. A final draft of this is attached, together with the proposed arranged written PQ and answer. Copies will also be sent on 25 November to the Select Committee on Industry and Trade, who have requested them in connection with their proposed examination of the Secretary of State and Mr Lamont on 9 December.

The Memorandum and the Government's Reply to the Select
Committee's Report

The most recent comprehensive set of calculations relating to Concorde to be placed before Parliament were those in the Department's memorandum to the Select Committee on 3 March 1981. These were necessarily tentative and inconclusive. The Department were, at the time, in the middle of a comprehensive review of Concorde support tasks to adjust them to lower levels of Concorde airline utilisation. The estimates of the costs of these support tasks to public funds, based on the PES 1981 proposals, therefore excluded a large number of PES contingent items, mostly pointing in the direction of lower expenditures and increased receipts, which were expected to become certain events later in the year and consequently taken into account in revised estimates. This in turn meant that a little reliance could be placed on the then comparisons, requested by the Committee, of the relative costs of continued Government financial support of Concorde and its early cancellation by mutual agreement with all the parties concerned.

The Government's reply, published just three months after the Committee's 14 April report and the subject of Mr Tebbit's letter to Sir Keith Joseph of 22 June, provided an interim assessment of the way definitive estimates, both for continuation and for



cancellation, were shaping up. However, the examination of Concorde tasks still had to be completed; and because of this, and the reduced numbers assumed to be employed on Concorde (which meant that estimates costs of mutually agreed cancellation were also falling), the July assessment was also inconclusive. Parliament was therefore promised that:-

- a Action would be continued across a broad front to achieve further reductions in public expenditures, in line with the Committee's first alternative recommendation.
- b Additionally the Department were taking action to review the relative costs of continuation and of mutually agreed cancellation.

The present memorandum provides definitive information on both points, and in both cases the assessments are now clear cut.

The estimated project costs of continuation, as borne on the Department's Concorde Vote and summarised in Table A, are now very substantially below those made last January for PES 1981 purposes and included in the March memorandum. In the context of the present bilateral discussions between the Treasury and spending departments and the preparation of Financial Estimates for 1982-83, the Department's PES 1981 proposals have been adjusted accordingly. Additionally, although this falls outside the period to which the memorandum relates, MOD (PE) are now expecting a substantial additional receipt in the current financial year in full and final settlement of the Government's claim on British Aerospace for the loss of airframe spares. This Appropriation in Aid to will serve to continue and enhance a general trend towards sharply declining net expenditures on Concorde.

Taking account of an expected continuation of operating surpluses on British Airways' North American Concorde services, for which the airline's current estimates are shown in Table B, there is now a reasonable expectation - even on a pessimistic view of the airline's prospects - that the net cost of public funds of Concorde will be well below £10 million from 1983-84 onwards. Indeed, it is not out of the question that a surplus could be attained shortly thereafter.

Compared with the March estimates, the costs of early mutually agreed cancellation, as set out in Table B, have also fallen, but not nearly as steeply as those for continuation. Consequently they now greatly exceed the estimated costs of continuation. This, in itself, would appear to rule out early cancellation as a sensible British objective, even if it were not for the fact that the French Minister of Transport indicated at his meeting with my Minister on 29 October that he too excluded this as a practical option.

Anglo-French Studies on the Future of Concorde

If some aspects of Concorde finances and policies have now been clarified, other important and complex issues have since arisen to



take their place. This results from last September's Summit agreement between the British and French Governments to commission joint studies on the future of Concorde.

As recorded in the memorandum and in the PQ, officials are to study two options, namely those of a phased rundown and of indefinite continuation. The uncertainties about the outcome of these studies, and of the British and French Governmental decisions to which Ministers will subsequently need to address themselves, arise from the facts that:-

a A phased rundown has several meanings (paragraph 6 of the memorandum), all aspects of which are to be studied. The meaning that most appeals to the French and which, if Concorde is to be cancelled, is probably the least costly to British public funds, is that British Airways as well as Air France should cease Concorde operations simultaneously. However, even if the Government had the power to do so, it would be very difficult for Ministers to direct British Airways to cease a profitable Concorde operation merely because Air France could only operate at a loss.

b The indefinite continuation option will need to be assessed both without the expenditures and receipts arising out of a Federal Express transatlantic parcels service using leased British Airways and Air France Concordes (as in the present memorandum), and with such an operation, taking account of airline as well as project aspects.

c Federal Express have indicated that they would go ahead with their - potentially lucrative to British and French interests - operation only if they secure firm assurances from both Governments of their continued willingness to underwrite financial support by their respective manufacturers of Concorde operations for at least the five years 1983-88. The implications of this will require serious consideration, both domestically and on an Anglo-French basis.

d In the British case, it is arguable that - taking the net revenues which British Airways would derive from leasing aircraft to Federal Express, from maintaining them, and from their scheduled airline services - there would be no need for continuing Government subventions to British Aerospace and Rolls-Royce to meet their losses in providing support. This proposition will need to be studied, both from the domestic UK standpoint and in the Anglo-French context (which may dictate, in British national interests, a contrary approach based on a continuation of existing contractual procedures in both countries).

e As foreshadowed in the Government's reply, my Minister put down a marker with M Fiterman on 29 October that any agreement between the two Governments on the future of



Concorde would need to take account of the equal sharing provisions of the 1962 Agreement, and more especially of the imbalance, adverse to the United Kingdom, which Mr Tebbit had discussed with the French Transport Minister on 19 January last. M Fiterman acknowledged that an imbalance existed, and while his proposed method of settling this was quite unacceptable to Mr Lamont, the way is now open for matters to be pursued between the two Governments on a more realistic basis than hitherto.

f All this has to be fitted into a very tight timetable, with officials being required to report early in 1982, and with M Fiterman and Mr Lamont being on public record as having agreed to meet in the first quarter of 1982 to reach conclusions on the two options presented to us.

Presentation and Timing

The memorandum has been prepared in consultation with, and on the advice of, an interdepartmental Concorde Select Committee Calculations Working Group of officials, and represents an agreed assessment. The proposal to present it to Parliament under cover of an arranged PQ, with copies to the Committee, rather than to the Committee alone, reflects the fact that the Committee's report and the Government's reply, to which the memorandum forms a natural sequel, were both made to Parliament.

In order that they can be taken into account in a Steering Brief for our Ministers' appearance before the Committee, comments by Thursday 26 November are desirable.

I am copying this letter and attachments to the Private Secretaries to the Prime Minister, all members of E(EA), the Lord President, the Lord Privy Seal, the Chancellor of the Duchy of Lancaster, the Chief Whip and the Minister of State for Defence Procurement, and to David Wright (Cabinet Office).

Yours ever

Peter

PETER MASON
Private Secretary

71 1251 31

10 11 12 1 2
3 4 5 6 7 8 9

TS/1/664
FINAL DRAFT
(as revised)
17 November 1981

CONCORDE
DRAFT ARRANGED PRIORITY WRITTEN P1

To ask the Secretary of State for Industry, what action he has taken to reduce the incidence of the costs of Concorde to public funds, as recommended in the report of the Select Committee on Industry and Trade; when the results of the review of the relative costs to public funds of continuation and of cancellation of Government financial support for Concorde, referred to in the Government's reply, will be made available to Parliament; and what options are being considered in the joint studies on the future of Concorde commissioned by the British and French Governments on the occasion of the September Anglo-French Summit.

MR PATRICK JENKIN

In conjunction with the manufacturers, the Procurement Executive of the Ministry of Defence, who act as the Department's agents in the day to day technical and financial control related to the project, have undertaken a comprehensive examination of the support required for Concorde in present circumstances, and of project expenditures and receipts. The results of that examination, and of the review of the relative costs of continuation and of mutually agreed^{early} cancellation, are set out in a memorandum by the Department of Industry which, in accordance with the Government's undertaking of last July, has today been placed in the Library of the House. Copies have also been sent to the Select Committee.

In a report to the Ministerial meeting between my hon Friend, the Minister of State for Industry (Mr Lamont), and the French Minister of Transport on 29 October British and French officials proposed that they should study three options on the future of Concorde, namely early cancellation (i.e. from 1 April 1982) mutually agreed, a phased rundown, and indefinite continuation.

The Ministers agreed that the first option need not be the subject of further joint study. The officials will therefore now consider the two remaining options, with a view to presenting a report on them to the two Governments early in 1982. As recorded in the Communique, of which a copy has been placed in the Library of the House, the Ministers have agreed to meet again in the first quarter of 1982 to reach conclusions on them.

I have accepted an invitation by the Select Committee to appear before them on 9 December to assist in their consideration of these matters. I shall be accompanied by my hon Friend, the Minister for Industry.

17 November 1981

REDUCTIONS IN CONCORDE COSTS TO PUBLIC FUNDS AND
REVIEW OF RELATIVE COSTS OF CONTINUING AND OF CANCELLING
GOVERNMENT FINANCIAL SUPPORT FOR CONCORDE

Memorandum by the Department of Industry

1. In its reply of 14 July 1981 (Cmnd 8308) to the Second Report from the Industry and Trade Committee for the Session 1980-81 (HC 265) the Government:-

- (a) Indicated that it was already taking action, as described in the reply, in line with the Committee's alternative for a reduction of the incidence of Concorde costs to public funds.
- (b) Stated that action will be continued across a broad front to achieve further reductions in public expenditures, and to increase Concorde project receipts.
- (c) Advised that the Department of Industry were currently reviewing comprehensively the relative costs of continuation and of mutually agreed cancellation of Government financial support for Concorde, as previously given to the Committee, to reflect changes in circumstances generally.
- (d) Undertook to make the results of this review known to Parliament.

2. The present memorandum accordingly:-

- (a) Describes, in paragraphs 7 to 11, the action taken over the past twelve months to reduce the incidence of Concorde costs to public funds, as in the first of the Committee's alternative recommendations.
- (b) Quantifies the expected overall financial results of such action, and compares current estimates of costs of in-service support with estimates, in respect of a generally higher level of in-service support activities, as given to the Committee earlier in 1981 (paragraph 9 and Table A).
- (c) Provides fresh projections by British Airways of their Concorde operating surpluses (which, in terms of the net costs of Concorde to public funds, form an offset to net project expenditures), and the airline's explanations of the basis of their calculations (paragraphs 16 to 20 and Table B).
- (d) Compares the estimated total cost to public funds so obtained (the costs of continuation) with the estimate of costs of mutually agreed cancellation^{of} financial support with effect from 1 April 1982 (paragraphs 12 to 32 and Table B). The reasons why 1 April 1982 was chosen for the purposes of the comparison are set out in paragraph 21.

Developments Affecting Concorde Calculations

3. The most recent comprehensive set of calculations relating to the Concorde project to be placed before Parliament were those contained in:-

- (a) The Department of Industry's memorandum of 3 March 1981 to the Select Committee, which contained summary estimates of Concorde project finances (Table D), and estimates of the relative costs to public funds of continuing British Government contracts for Concorde in-service support, and of cancelling them with effect from 1 October 1981 (Table E).
- (b) The Department's memorandum of 23 March 1981, which gave an analysis of Concorde project expenditures and receipts by Financial Estimates forecast headings (Table F), and by British Aerospace and Rolls-Royce Production Brochure headings (Tables G to J).

4. Since then there have been a number of developments which affect the content and presentation of Concorde calculations, both in the present memorandum and in any subsequent exercise:-

- (a) On the occasion of the Anglo-French Summit of September 1981, the British and French Governments commissioned joint studies by British and French officials, as represented on the Concorde Management Board, on the future of Concorde (paragraphs 5 and 6 below).
- (b) The Government, having laid before Parliament Financial Estimates for 1981-82 calculated at 1981-82 forecast outturn prices, has now decided that Public Expenditure Survey (PES) calculations, as made for inclusion in the next Public Expenditure White Paper, shall be in cash (ie forecast outturn) terms, rather than at constant economic conditions, as previously (paragraph 34

- (c) The comprehensive reassessment of Concorde support activities referred to in paragraph 1 (b) above, has now been completed, and the financial results expected from such reassessment evaluated (paragraphs 7 to 11 and Table A attached).

The implications of these changes are described below.

Anglo-French Studies on the Future of Concorde

5. This is the first occasion, since the project was inaugurated by Treaty between the two Governments in 1962, that joint British and French studies will have been undertaken that have, as one possible out-come, the termination of the project. At the Anglo-French Ministerial meeting on 29 October 1981 British and French officials proposed that their studies should cover three options namely those of:-

- (a) Early cancellation, ie from 1 April 1982, mutually agreed
This is the option for which British officials had already produced calculations in connection with the review of the relative costs of continuing and of cancelling British Government contracts for the in-service support of Concorde, as set out in the present memorandum. ^{However,} the Ministers decided that this matter need not be the subject of the joint studies.
- (b) A phased rundown As indicated below, this is capable of several meanings; and, for this and other reasons, it can best be evaluated on a joint Anglo-French basis. It has not therefore been the subject of previous studies by British officials, even on a hypothetical basis, in the same way as the two other options.
- (c) Indefinite continuation In the British content, this has been studied and reported upon on a number of occasions, including the present memorandum; and, in

the Anglo-French context, as part of the cost sharing studies made by British and French officials (Annex E to Department of Industry's memorandum to the Select Committee of 6 October 1980, and paragraphs 4 and 5 of covering letter).

6. A phased rundown could be taken to mean:-

- (a) Only the cessation of Government financial support for their respective manufacturers to meet any losses in discharging ^{the} manufacturers' contractual obligations to their airline customers for Concorde in-service support (such financial underpinning being currently given by both Governments).
- (b) Or additionally the cancellation of financial support to meet losses incurred on Concorde airline operations (such support being given only in France).
- (c) Or, in addition to (a) and (b), that Concorde airline operations should cease in both countries. This is the meaning attached by the Select Committee who, in the second and alternative recommendation of their report, proposed that, depending on the results of a total reappraisal of current and future costs of operating Concorde, HMG should be ready to enter early discussions with all interested parties to ensure a speedy agreement to discontinue the operation of the aircraft at the earliest possible date, which the Committee hoped would occur no later than 1985 (Conclusion viii (b)).

The Ministers agreed that all three aspects should be studied.

Action Taken to Reduce Concorde Project Costs and to Increase Receipts

7. Concorde entered airline service with British Airways and Air France in January 1976. In the period to mid-1980 utilisation of the aircraft increased markedly. However, the manufacturers' support activities in both countries, past, present and future, were geared to support a much higher level of utilisation, both by the nine British Airways and Air France Concorde originally purchased, and also by the remaining five aircraft which the two Governments had decided in 1979 should be placed with the two airlines.

8. From mid-1980 onwards it became increasingly clear that, not only had airline utilisation peaked (at least temporarily), but that the level at which it had peaked was well below that which had been postulated when plans for in-service support were originally drawn up. Additionally, many of the support activities in the early in-service period, eg the post certificate of airworthiness development of the airframe and engines, the building up of stocks of spares, etc. were by then near to completion. The stage was thus set for a vigorous and wide ranging review of all aspects of support, their costs, and the receipts to which it was expected they would give rise.

9. The costed outcome of this review is summarised in Table A, which updates the estimates contained in Table D of the Department's memorandum of 3 March 1981. Over the five year period 1982-83 to 1986-87 this shows a reduction in estimated net expenditures of some £46 million (£62 million in project expenditures and £56 million in estimated receipts) compared with estimates made at the time of the earlier memorandum. Compared with the estimates shown in Table D, which covered only the three year period to 1984-85, a reduction in net expenditures of some £28 million is expected to take place.

10. The decrease in estimated expenditures is brought about by:-

- (a) Curtailment of the major fatigue testing and related programmes (an estimated £36 million of savings over the five year period). This decrease was foreshadowed in paragraphs 5 and 6 of the Government's reply. It has since been recosted to provide budgetary cover for a programme of much less costly testing which entails only localised heating and cooling of certain parts of the major fatigue specimen, in place of the programme carried out hitherto, in which the entire specimen is heated and cooled. By concentrating supersonic testing on those parts of the specimen that have hitherto been undertested, the new programme is expected to achieve a greater degree of airworthiness cover, and thus extended aircraft life, than would have been the case had the existing, more generalised, programme been continued.
- (b) A scaling down of the engine spares provisioning programme, to reflect current expectations of a static level of utilisation of British Airways Concorde, and a reduction in Air France operations, increased operating lives of key engine components, and the ability, in many instances, to draw upon substantial stocks which have resulted from earlier manufacturing programmes (an estimated £7 million).
- (c) A corresponding scaling down of airframe spares production, occasioned mainly by the fact that production of spares and other support items for sale to independent Concorde operators is no longer required now that the two remaining British assembled Concorde have been placed with British Airways, and the three French aircraft with Air France (£5 million).

- (d) The restriction of the engine in-service support programme to that required for the maintenance of airworthiness and reduction of warranty expenditures (£9 million). This restriction was foreshadowed in paragraph 45 of the Department's memorandum of 6 October 1980, and is being progressively and rapidly implemented.
- (e) Reductions in funding required for Rolls-Royce work-in-progress in the production of engine spare parts (£5 million).
- (f) A package of lesser measures, arising out of a comprehensive search for economies in in-service support conducted jointly with French officials and the manufacturers in both countries, and announced on the occasion of the 29 October 1981 Ministerial meeting (£9 million).
- (g) A residual £11 million in respect of reductions in a wide range of other items.

11. The changes in estimated receipts are due to:-

- (a) A reduction in estimated receipts from the sale of engine spares, the result of a reappraisal of the requirements of British Airways and Air France in the changed circumstances described in paragraph 10(b) above (£16 million).
- (b) An offsetting £6 million arising from a weighted average 13 per cent increase in the real price of Rolls-Royce Olympus 593 spares from 1 February 1982, and the structuring of future spares catalogues to maintain the higher margins so achieved. This increase has been proposed in line with the Government's general policy of reducing the incidence of the costs of Concorde to public funds, by reducing expenditures and increasing receipts.

- (c) A reduction of £17 million in the estimated receipts from the sale of airframe spares, the counterpart of the reassessment of airframe spares production requirements referred to in paragraph 10 (c) above.
- (d) The elimination of an estimated £6 million of receipts in 1982-83 from compensation for the loss of airframe spares. This is because a full and final settlement of the claim is now expected in 1981-82.
- decrease
- (e) A residual . £5 million/in respect of other items.

The Estimated Costs of Continuation and of Cancellation

12. Table B sets out the Department's estimates of the relative costs to public funds of continuation and of cancellation on 1 April 1982 of British Government contracts for Concorde in-service support. The Table is similar in format to Table 7 of the Department's memorandum of 3 March 1981, but with the following changes:-

- (a) The figures are expressed at September 1981 economic conditions, instead of September 1980 conditions.
- (b) The estimates cover a five year period commencing on 1 April 1982 (the now earliest date assumed feasible for mutually agreed cancellation), instead of a three and a half year period commencing 1 October 1981. Within this period the figures are now analysed according to financial years.
- (c) To compare the results with the estimates furnished in March 1981, totals for the latter figures, adjusted and extended as necessary, have been added at the bottom row of Table B.

The main features of each column of figures are set out below.

Net Project Expenditures

13. Table B figures are derived from the estimates in the last column of Table A. The figures have been established in accordance with the procedures described in paragraph 4 of the Department's memorandum of 23 March 1981, and reflect the latest annual returns provided by British Aerospace and Rolls-Royce.

14. In accordance with Government accounting conventions, contingent items are excluded from both expenditures and receipts. Most of the items set out in the Annex to the Department's memorandum of 3 March 1981 have since become sufficiently firm for the relevant amounts to be included in the present estimates. The items which remain are now confined to the following:-

- (a) Potential additional receipts from the sale of airframe spares, should there be a real increase in prices similar to that in course of implementation for engine spares (paragraph 9 of the Annex, and paragraph 11(b) above). A decision on this is not due to be taken until fairly well into 1982.
- (b) Additional receipts should the eventual settlement of negotiations for compensation for the loss of airframe spares (as referred to in paragraph 12 of the Annex) result in a payment being received in 1982-83 or subsequently, contrary to the expectations held out in paragraph 11(d) above that a full and final settlement of the claim is now likely in 1982-83. The amount of such receipts would depend upon the outcome of the negotiations for a settlement in the current financial year, which are still in progress, and cannot therefore be quantified.
- (c) Additional expenditures arising from the need to give in-service support to a possible transatlantic parcels service by Federal Express using leased British Airways and Air France Concorde, and additional receipts resulting from the sale of airframe and engine spares and other support items for such a service. This contingent item has arisen since the March 1981 list was compiled. The amounts and timing of such expenditures and receipts, and whether they take place at all, will depend upon the outcome of negotiations currently in hand between the carriers concerned. It

has been agreed that they shall be evaluated in the context of the Anglo-French studies referred to in paragraphs 5 and 6 above.

15. Contingent items relate to foreseen events. Additionally, during the period covered by the attached estimates there could be other items arising which, not being currently foreseen, could require expenditures or give rise to receipts over and above those included in Table A or referred to in paragraph 14 above.

British Airways Operating Results

16. As with previous submissions, the figures for the British Airways Concorde operating results are based on estimates provided by British Airways themselves, and for which the airline therefore take responsibility. To the extent that they reduce British Airways' potential borrowing requirements, they represent a reduction of the costs of Concorde to public funds (footnote (4) to Table B). The only adjustment the Department have made to the airline's estimates is to add an allowance to the airline's projected expenditures and consequently to reduce their forecast operating surpluses to cover the increase in the real price of Rolls Royce engine spares, referred to in paragraph 11(b) above and in footnote (4) to Table B.

17. British Airways have not prepared detailed estimates of Concorde operating results beyond 1983-84. They consider it to be a [estimated 1983-84 operating surplus into later years so as to enable the Department to present a comprehensive assessment of the total costs of continuation at constant September 1981 economic conditions over a five year period. Table B has therefore been drawn up on this basis.

reasonable basis for estimation, however, to continue their

17. As a result of the factors mentioned below British Airways' forecast operating surpluses are now somewhat larger than in the calculations presented last March. They reflect the following British Airways assumptions:-

(a) Concorde services, now confined to New York and Washington continue on these routes only, no allowance being made for any new services or for the lease of aircraft to Federal Express for a possible transatlantic parcels operation.

, followed by
nil growth in
1982-83, and
by 2 per cent

(b) Passenger numbers reflect a decline in the total market in 1981-82 of 10 per cent/per annum growth thereafter. Moreover, retimings and additional frequencies from October 1981 are assumed to contribute once and for all increases in passenger numbers of 21 per cent in Winter 1981-82, and of 10 per cent in Summer 1982, on the New York route; and of 7 per cent in Winter 1981-82, and 3½ per cent in Summer 1982, on the Washington route. The Winter 1981-82 assumptions, both for New York and for Washington, are after allowance has been made for the 10 per cent decline in the total market, i.e. if it had not been for this factor, the percentage increases assumed to accrue from retimings and additional frequencies would be 31 per cent and 17 per cent respectively. The sensitivity of the calculations to these assumptions is indicated in paragraph 19 below.

(c) Except where there are abnormally sharp movements (which may impose a temporary time lag), increases in the cost of bought in supplies, particularly fuel and oil, can be passed on in the shape of higher fares without significant loss of revenues.

(d) Cost increases under British Airways' direct control, mainly wages, salaries and overheads, will be limited in line with the airline's general policies of cutting costs and improving its productivity in response to current financial challenges.

- (e) The benefits of reduced costs and improved productivity arising under (d) above, when coupled with a sustained level of revenue yields, will produce higher operating margins and increased operating surpluses above expected 1981-82 levels.

19. As will be apparent from the year by year comparisons of net project expenditures and British Airways surpluses, as shown in Table B, the net total costs to public funds of continuation are particularly sensitive to whether or not the airline's Concorde operating results turn out as forecast. In order therefore to test the sensitivity of the airline's Concorde results to changes in traffic forecasts, and thus the sensitivity of the total net continuation costs, British Airways have, at the Department's request, assessed the effect of removing from their calculations the benefit of the improved frequencies and retimings. British Airways estimate that this would reduce their forecast operating surplus by some £3.5 million in 1982-83, and by an equivalent amount at constant September 1981 economic conditions in each subsequent year, making a total reduction of £17.5 million over the five year period 1982-83 to 1986-87. These projections, and their sensitivities, will fall to be reassessed in early 1982 in the context of the Anglo-French studies referred to in paragraph 5 and 6 above, when some experience will have been gained of the initial impact of the new schedules and frequencies on passenger numbers.

20. British Airways' projected operating surpluses are also susceptible to adjustment in an upward direction, should the current negotiations with Federal Express due for completion by April 1982 lead to the lease of two Concorde for a transatlantic parcels service, and to a contract for their maintenance. While much preparatory work has already been done in confirming the economic attractiveness and practical feasibility of such a service, the commercial aspects have yet to be the subject of substantive negotiations, whether between British Airways and Federal Express, or between Federal Express and Air France, with whom a broadly similar arrangement is proposed. But with Concorde capable of generating revenues when carrying high value parcels up to some three and a half times the revenues that can be generated by conveying passengers, there is clear potential for a marked improvement in the operating results of both airlines, and in the case of British Airways of prospects for the early commencement of payments of 80 per cent of accumulated operating surpluses to the Government, taking account of surpluses from these activities as well as from scheduled passenger services. For these reasons it has been agreed that the Anglo-French studies shall take account of the airline implications, as well as the project effects referred to in paragraph 14(c) above, of a possible Federal Express operation, as well as evaluating Concorde finances (as does the present memorandum) on the basis of continuation without the potential benefits to the two Governments, the four manufacturers, and the two national airlines, of a Federal Express operation.

Contractual Costs of Cancellation

21. These are mainly the costs that would be incurred by the Government in involving the standard three months 'break' clause in its contracts with British Aerospace and Rolls-Royce, less receipts from the manufacturers during that period. They are therefore sensitive to the date on which it is assumed that formal notice of termination of their contracts with HMG is given to the manufacturers. Thus, because the calculations assume mutually agreed cancellation to be implemented with effect from 1 April 1982, instead of from 1 October 1981 as previously, they now exclude both the £11 million of airframe spares compensation stage payment postulated to fall due in the financial year 1981-82, and the £6 million of former 1982-85 receipts referred to in paragraph 11(d) above which are now assumed to fall due in 1981-82. This in turn results in the balance between payments and receipts now showing a substantial net payment by HMG to the manufacturers in the event of cancellation, compared with the net receipts by HMG from the manufacturers shown in the March 1981 calculations. The date of 1 April 1982 represents an agreed assessment by British and French officials of the earliest date by which formal notice of termination of contracts could have been given, had the Ministers at their meeting on 29 October 1981 decided to begin negotiations between the two Governments, the two British and two French manufacturers, and the two national airlines, for early cancellation by mutual agreement between all the parties concerned, and to a mutually agreed timescale. It is also assumed, when making the calculations that, until formal notice of termination of contracts is given to the manufacturers, the tasks designated under the contracts continue to be performed and to be paid for, and that Concorde airline operations, and hence the need for support and manufacturers' and Government revenues from support, also continue.

Severance Costs of Cancellation

22. These are derived by taking the number of jobs lost as a result of cancellation of the Government's contracts with the manufacturers, and by the consequent cessation of Concorde airline operations, as assessed by the employers in question, multiplied by each employer's assessment of the average amount of severance pay that would need to be given in respect of each employee leaving under a voluntary redundancy scheme. Such amounts would be met partly out of receipts from the statutory Redundancy Fund. The balance would be met:-

- (a) In the case of British Aerospace and Rolls-Royce, by payments made by MOD (PE) under their contracts with the manufacturers. Severance payments at the rates assumed by these firms would be in accordance with established MOD (PE) practice in implementing the standard cancellation provisions as applying to Government contracts generally.
- (b) In the case of those sub-contractors and suppliers to Rolls-Royce who have a contractual relationship with the manufacturer of a kind that could entitle them to have severance payments to their employees met out of the Department's Concorde Vote, by payments made by MOD (PE) of a similar amount per employee to that assumed for Rolls-Royce. There are no such sub-contractors and suppliers to British Aerospace.
- (c) In the case of British Airways, there being no specific contracts between the Government and the airline which would cover severance payments, by payments out of the airline's general funds. In current circumstances, this would add to the airline's borrowing requirement, and hence to the Public Sector Borrowing Requirement.

23. Table 7 groups all severance payments, however arising, under a single column. Thus, in the case of:-

(a) British Aerospace, Rolls-Royce, the sub-contractors and suppliers, the amounts concerned are additional to those shown in the previous column in Table B entitled "Contractual Costs of Cancellation".

(b) British Airways, the amounts concerned are additional to those in the following column in Table B entitled "Other PSBR Costs of Cancellation".

24 . The reduction in total estimated severance payments compared with the figures included in the March 1981 calculations results from substantially smaller total numbers (an estimated 1,700 compared with some 3,200) now considered to be employed on Concorde at the later date now assumed for cancellation, namely 1 April 1981. As against this, as was foreshadowed in paragraph 3(d) of the Government's reply to the Select Committee report, there is no longer scope to transfer labour at British Aerospace and Rolls-Royce to defence contracts. The assumptions included at the present calculations as to redeployment possibilities, and how they compare with those assumed for the purposes of the March 1981 calculations, are therefore that:-

(a) In the case of British Aerospace, any job losses arising out of Concorde cancellation would have to be met by a corresponding reduction in the firm's total workforce, and could not be partially offset by redeployment within the firm, for which an allowance of 25 per cent of total numbers was included in the previous calculations.

(b) In the case of Rolls-Royce, some 15 per cent of Concorde workers would be retained, compared with 25 per cent assumed for the previous calculations, and would in due time fill expected future vacancies.

(c) In the case of Rolls-Royce's suppliers and sub-contractors, any job losses arising out of Concorde cancellation would have to be met by a corresponding reduction in their total workforce (a similar assumption was made previously).

- (d) In the case of the Royal Aircraft Establishment, Farnborough, the relatively small numbers on Concorde could be reabsorbed in full within the organisation.
- (e) In the case of British Airways, reflecting the airline's general moves to reduce manning, any job ^{losses} arising out of Concorde cancellation would have to be met by a corresponding reduction in the airline's total workforce over and above the reduction envisaged by current manning policies (a similar assumption was made previously, though not related to current general moves to reduce manning).

25. The calculations are statistically sensitive to the following factors:-

- (a) It is assumed that, given the relatively small numbers now involved, any reductions in the workforce of the employer concerned as a result of cancellation of Concorde contracts would be brought about by a voluntary redundancy scheme, and not by compulsory severance. Under such a scheme the employees leaving would not necessarily be those of formerly employed Concorde. However, for the purposes of calculating the average amount of severance pay, it is assumed that the age, sex and skill profiles of those leaving would be similar to that of the existing Concorde labour force. (including, where appropriate, indirect as well as direct employees). This assumption is in turn used when calculating the other PSBR costs of cancellation, as referred to in paragraphs 26-33 below. A different profile of actual jobs lost could produce different calculations; the difference could be either positive or negative depending upon the amount by which such profiles differed from the Concorde employee

profile, and the direction of such differences.

- (b) In the case of British Aerospace and Rolls-Royce (whose combined Concorde employment accounts for about two thirds of the figure of 1,700 referred to in paragraph 23 above), it was possible to include an allowance for employees not specifically allocated to Concorde, as well as direct employees, when calculating the number of jobs lost through cancelling contracts. However, in the case of British Airways, it has been possible to take account only of those employees who are clearly identifiable with Concorde operations. To that extent the severance costs to British Airways associated with cessation of Concorde operations on 1 April 1982 are understated, as are the other PSBR costs of cancellation.

Other PSBR Costs of Cancellation

26. These consist of the additional Exchequer costs payable in Unemployment Benefit, including Earnings Related Supplement, and revenue losses from direct taxation and National Insurance contributions. They assume that the number of jobs lost is as described in paragraph 24 above, less an allowance for jobs that would be lost even if the project continued, but including an allowance for jobs lost at vendors, i.e. firms supplying directly to the airlines, for whom no requirement therefore exists to meet severance payments out of public funds.

27. The figures depend upon the speed with which the workers made redundant as a result of cancellation find other jobs. The characteristics of the existing Concorde workforce, and the evidence of a number of redundancy studies, suggest that the ex-Concorde workers (or their equivalents under a voluntary severance scheme) would find work relatively quickly. However, it is much

harder to predict the extent that their re-employment would displace other unemployed people who would otherwise have found employment. The calculations in Table B have used a faster rate for net re-employment of the displaced workers (assuming no displacement of other job seekers) than was used in previous calculations. Thus they assume that 25 per cent of those discharged find work by the end of the three months rundown period for Government contracts referred to in paragraph 21 above, i.e. on 1 July 1982; that jobs are created for a further 25 per cent at the end of 1982-83; for a further 25 per cent at the end of 1983-84 and a further 25 per cent at the end of 1984-85.

28. This new assumption, which is one of a possible range, partly reflects more detailed information about the composition of the Concorde labour force than was available when the previous estimates were made, and about job opportunities in the areas where the redundancies occur. It also gives greater weight to more general factors affecting the speed of labour market adjustment, for the following reasons.

29. Concorde cancellation would increase unemployment for a period in the local area concerned. But it is the impact on national employment levels of that decision that is much more difficult to assess. In the long run the level of national unemployment will depend on a number of factors, but will be unaffected by individual closure decisions. However, over the shorter period being considered here, a decision to cancel Concorde would lead to some increase in overall national, as well as local, unemployment above its underlying long run level.

30. Reflecting the new assumptions about the rate of job creation set out in paragraph 27 above, the current estimates of other PSBR costs, as shown in Table B, are less than one third of the March 1981 estimates. It is therefore worthwhile measuring the sensitivity of the calculations to the changed assumptions. In this connection the effect of the new assumed rate of job creation can best be judged by estimating what other PSBR costs would be on the new job loss figures, but at the previous assumed rate of job creation. This calculation would increase the other PSBR costs from the £10.4 million shown in Table B to £18.3 million. This is still little more than half the March 1981 estimates, but is in line with the reduction of the assumed Concorde workforce, as indicated in paragraph 24 above, of whom a rather greater proportion could now stand to be added to the numbers of job seekers in the event of cancellation than was the case earlier this year.

31. In practice another important consideration affecting unemployment levels would be the way in which a cancellation decision might be announced. Sudden closure without warning is much more likely to result in longer periods of higher unemployment than if a longer period of notice is given, because the discharged workers would all be thrown onto the labour market at once. The assumption of a 25 per cent re-employment within three months of termination of the project is unlikely to be consistent with an unexpected and sudden decision to cancel. It would, however, be consistent with a decision of the Anglo-French Ministerial meeting on 29 October 1981 to propose for consideration by the parties

concerned cancellation with effect from 1 April 1982, had such a decision been taken. On the other hand, a decision taken at some time in the future to cancel giving longer notice than this would, by spreading out Concorde redundancies, reduce the PSBR costs of unemployment from cancellation below those calculated in Table B.

32. Overall there has been a very considerable reduction in the estimated PSBR costs of cancellation compared with the previous calculations. This reflects:-

- (a) A sharp reduction in the numbers taken to be employed on Concorde since the last set of calculations.
- (b) More detailed information about the composition of the Concorde labour force, and about job opportunities in areas where the redundancies would occur.
- (c) An assumed more rapid rate of job creation, both for reasons specific to Concorde and as a result of giving greater weight to general factors affecting the speed of labour market adjustment.

Other Considerations

33. The estimates in Tables A and B, and the figures of the preceding paragraphs, are all at constant September 1981 economic conditions. There are, however, other ways of measuring the incidence of Concorde expenditures and receipts. of which the following are the most important.

(a) Forecasts in Cash Terms

34. As indicated in paragraph 4(b) above, forecasts of public expenditure are in future to be presented to Parliament in cash, ie forecast outturn, terms rather than at constant prices. This will make it easier for Parliament, both generally and in respect of individual programmes such as Concorde, to assess the likely impact on the level of public expenditures and revenues. At present, however, such estimates cannot be made for Concorde beyond 1983-84 for all the items listed in Table B; and, even for earlier years, definitive figures are not, as yet, available.

(b) Discounted Figures

35. The net costs to public funds of mutually agreed cancellation are estimated to be £34 million for the five year period reviewed and compare with net costs over the same period for continuation of £6 million. Discounting both revenue and costs would take account of the value placed on money at different points in time; but, in this case, this would in fact have a negligible effect on the relative cost of continuation and cancellation, and therefore has not been presented.

(c) Resource Costs and Transfer Payments

36. The cost figures discussed here may be viewed in principle either as cash flows between the Exchequer and the private sector or, in the case of cost items in the continuation option, they can equally be viewed as resource costs which measure the total loss of income to society. It is arguable that the cost of contractual payments in the case of cancellation can also be seen as a resource cost. The other cancellation costs (redundancy costs and the loss of tax receipts plus higher unemployment payments) are transfer payments between individuals, and consequently do not represent a loss of national income. They do, however, represent additional public expenditures which, if they are incurred, can only be met by corresponding reductions elsewhere in public expenditures, or by higher taxes, or by increased borrowing.

Conclusion

37. In its reply to the Select Committee's report the Government noted that there were substantial opportunities for bringing down the total costs of continued Government financial support for Concorde, and stated that action will be continued across a broad front to achieve further reductions in public expenditure, and to increase Concorde receipts.

38. The results of this action are set out in paragraphs 7 to 11 above, and in Table A. The latter indicates that estimated net project expenditures for the three years 1982-83 to 1984-85 show reductions of 33, 56, and 53 per cent respectively on the previous corresponding figures; even more substantial reductions are forecast for the two subsequent years for which calculations are now presented.

39. The Government's reply also indicated that additionally the Department of Industry were currently reviewing comprehensively the relative costs of continuation and of cancellation, as previously given to the Committee, to reflect changes in circumstances generally. The results of this action are set out in paragraphs 12 to 36 above, and in Table B. The latter indicates that, for the five year period 1982-83 to 1986-87 now adopted, the estimated net costs of mutually agreed cancellation, at some £34 million, are considerably higher than the net costs of continuation, at some £6 million.

40. In presenting this comparison the Department note that this memorandum provides, on the one hand estimates of the costs to public funds of continuing Government financial support for Concorde under existing contracts between the Government and British manufacturers, and on the other hand the estimated cost to public funds of mutually agreed cancellation of Government financial support for Concorde with effect from 1 April 1982 by termination of these contracts. This comparison follows the lines of earlier evidence to the Select Committee. But the Department recognise that the choice of action would not necessarily lie simply between early cancellation, ie from

1 April 1982, of support, or indefinite availability of support. There is also, as noted in paragraphs 5 and 6, the possibility of a phased rundown of Government support, which would have different public expenditure implications. The various aspects of a phased rundown are being studied by British and French officials with a view to their reporting on this option, and on that of indefinite continuation, to the two Governments early in 1982.

41 , The estimates in this memorandum and its tables represent the best assessments that can be made, at this point in time, of the costs of public funds of continued Government financial support of Concorde, and of how this relates to the costs of early cancellation. As was the case with previous forecasts, continued efforts have been made to avoid bias in these calculations; and contingent items, of a generally favourable potential impact on Government expenditures and revenues, have continued to be excluded from the calculations, both on project and on airline account. As indicated above, the individual items which go to make up these estimates are, however, subject to varying degrees of statistical sensitivity, depending upon the fulfilment or non-fulfilment of the assumptions on which the calculations are based; and new events may further alter the figures. In this connection, it remains the case that, as noted in the Government reply to the Select Committee's report, frequent adjustment of figures must be expected with any programme, such as the Concorde programme, which is undergoing rapid change. Where adjustments have been made, or may be required in the future, the reasons have been explained.

Department of Industry
25 November 1981

TABLE A: CONCORDE PROJECT FINANCES

£ Million

at constant September 1981 economic conditions

Year	JANUARY 1981 FORECASTS			MARCH 1981 FORECASTS			PRESENT FORECASTS		
	Expend- itures	Receipts	Net expend- itures	Expend- itures	Receipts	Net expend- itures	Expend- itures	Receipts	Net expend- itures
1982/83	50.7	22.6	28.1	52.0	25.9	26.1	31.1	13.5	17.6
1983/84	46.1	23.3	22.3	40.7	20.0	20.7	21.3	12.2	9.1
1984/85	45.0	24.2	20.8	33.1	13.5	14.6	18.3	12.0	6.3
<hr/>									
total 1982/83- 1984/85	141.8	70.6	71.2	125.8	64.4	61.4	71.2	27.7	33.5
<hr/>									
1985/86	NA	NA	NA	30.4	16.5	13.9	15.5	12.0	3.5
1986/87	NA	NA	NA	28.0	16.7	11.3	15.7	11.3	5.9
<hr/>									
total 1982/83- 1986/87	NA	NA	NA	184.2	97.6	86.6	102.4	61.5	40.9

- NOTES: (1) Basis of forecasts This table updates forecasts of British Concorde project expenditures and receipts, as given to the Select Committee on Industry and Trade by the Department of Industry on 3 March 1981 and reproduced by the Committee at page 106 of the Committee's Minutes of Evidence. They represent the Department's best estimates of the costs of carrying out agreed Concorde tasks, and of receipts therefrom.
- (2) Economic conditions All figures are at September 1981 economic conditions.
- (3) Concorde Vote items The present forecasts (unlike ^{those in} Table D of the Department's memorandum of 3 March 1981) take account of forecast receipts from capital assistance rentals of some £0.3 million annually. Since the previous forecasts were presented these receipts have been reclassified by Treasury as a Public Expenditure Survey (PES) item.
- (4) Contingent items In accordance with Government accounting conventions contingent items are excluded from both expenditures and receipts. The principal contingent items, as applying to the March 1981 forecasts, were set out in the Annex to the Department's memorandum of 3 March 1981 (pages 109 to 110 of Committee's Minutes of Evidence). Since that date, the majority of such items have become certain events, and are consequently taken into account in the present forecasts (see paragraph 14 of memorandum).
- (5) January 1981 forecasts The estimates are as given in Table C to the Department's memorandum of 27 January 1981 (and subsequently in Table D of the memorandum of 3 March 1981), revalued to September 1981 economic conditions.
- (6) March 1981 forecasts The estimates are as given in Table D to the Department's memorandum of 3 March 1981, revalued to September 1981 economic conditions.
- (7) Figures for 1985-86 and 1986-87 The January 1981 and March 1981 forecasts, as included respectively in the Department's memoranda of 27 January and 3 March 1981, covered the period to 1984-85. In the latter case, calculations for 1985-86 and 1986-87 were, however, also made for project planning purposes, but were not included in the 3 March 1981 memorandum. To give a basis of comparison between previous and present forecasts, both in this table and in Table B (which likewise covers a five year period), they are now included, revalued to September 1981 economic conditions.

TABLE B - RELATIVE COSTS TO PUBLIC FUNDS OF CONTINUING AND CANCELLING

BRITISH GOVERNMENT CONTRACTS FOR CONCORDE IN-SERVICE SUPPORT

£ million
at constant September 1981 economic conditions

Period	Costs of Continuation			Costs of Cancellation			
Financial Year	Net Project Expenditures	Less BA Surplus	Net Total	Contractual Costs/Receipts (+)	Severance Costs	Other PSBR Costs/Surpluses(+)	Net Total
1982-83	17.6	(+) 5.4	12.2	10.4	14.5	5.5	30.4
1983-84	9.1	(+) 7.4	1.7	(+) 0.3	N11	4.0	3.7
1984-85	6.8	(+) 7.4	(+)0.6	(+) 0.3	N11	1.9	1.6
1985-86	3.5	(+) 7.4	(+)3.9	(+) 0.3	N11	(+)0.5	(+) 0.8
1986-87	3.9	(+) 7.4	(+)3.5	(+) 0.2	N11	(+)0.5	(+) 0.7
	—	—	—	—	—	—	—
PRESENT TOTALS	40.9	(+) 35.0	5.9	9.3	14.5	10.4	34.2
PREVIOUS TOTALS	85.0	(+) 28.3	56.7	(+) 8.2	19.8	35.9	47.5

NOTES:

- (1) Basis of forecasts This table revises the estimates given by the Department of Industry to the Select Committee on Industry and Trade on 3 March 1981, and reproduced at page 107 of the Committee's Minutes of Evidence. Estimates for two further years, 1985-86 and 1986-87, have been added; and estimates are now expressed on an updated price basis (September 1981 instead of September 1980.)
- (2) All figures are at September 1981 economic conditions, and except where indicated by a (+) sign represent a cost to public funds.
- (3) Net project expenditures are for total costs to public funds, as met out of the Department of Industry's Concorde Vote. Thus they comprise expenditures less receipts as shown in Table A. The present forecasts take account of savings from PES 1981 contingent items, to which reference was made in paragraphs 5 and 6 of the Government's reply of 14 July 1981 to the Select Committee's report, as well as additional savings foreshadowed in paragraph 7 thereof.
- (4) British Airways surpluses are as estimated by the airline, less £0.5 million for each year to allow for a real increase in the price of Rolls-Royce Olympus 593 engine spares. They represent savings in the amount of the Government's Public Sector Borrowing Requirement (PSBR), and as such are deducted to arrive at a net total of the cost to public funds of continued Government financial support for Concorde.
- (5) Contractual costs of cancellation assume mutually agreed cancellation with effect from 1 April 1982. In 1982-83 they are net of receipts from the manufacturers during the three month break period of the contracts. They also include outstanding payments by British Aerospace under the Simulator Operating Agreement. For each year they reflect continuing income from capital assistance item rentals, which are also taken into account in the costs of continuation.
- (6) Severance costs as shown include all severance payments. Thus payments met by HMG under its contracts with British Aerospace and Rolls-Royce in respect of their discharged^a employees, as well as any settlements by Rolls-Royce when terminating contracts

with suppliers and subcontractors (estimated at £1 million) in respect of those companies employees, are included in this column and not under the contractual costs of cancellation. Similarly redundancy payments arising in other ways, eg out of the statutory Redundancy Fund, or by British Airways in respect of their own employees, are included in this column, and not as other PSBR costs. It is estimated that there would be no redundancies declared at RAE Farnborough in the event of cancellation.

- (7) Other PSBR costs The savings in 1985-86 and 1986-87 arise from the fact that many of the employees assumed to be made redundant in 1982 would have ceased working on Concorde between 1983 and 1987 even if the project had continued. The fact that, in the event of cancellation, they are all assumed to be made redundant in 1982 results in jobs being recreated earlier than would otherwise have been the case, hence the savings at the end of the period.
- (8) Previous totals are those in Table E of the Department of Industry's memorandum of 3 March 1981, adjusted to allow for the postponement of the assumed date of mutually agreed cancellation from 1 October 1981 to 1 April 1982, the extension of the calculations to include estimates for 1985-86 and 1986-87, and the revaluation of the figures from September 1980 to September 1981 economic conditions. Explanations for the principal reasons for the differences between the two sets of estimates are given in the text.