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From the  
Minister of State  
Norman Lamont MP

The Rt Hon Patrick Jenkin MP  
Secretary of State for Industry  
Department of Industry  
Ashdown House  
123 Victoria Street  
London SW1

Prime Minister

Agree, subject to the views of  
colleagues, to a, b, c

8 April 1982

at X  
overleaf?

MIS 8/4

Dear Patrick

#### THE FUTURE OF CONCORDE

I have now received the joint studies by British and French officials covering the three options agreed with the French Minister of Transport last Autumn (i) continuation without Federal Express, (ii) continuation with Federal Express and (iii) rundown and termination of services by British Airways and Air France on 1 April 1984. These studies together with the purely British study on mutually agreed cancellation from 1 October 1982 have been evaluated by my officials in consultation with other Departments. I attach a copy of their report, to which I have added an abstract of the British Airways component of the options set out in Tables A, B and C of the report. The next steps are to identify the underlying objective we should pursue at the Anglo-French Ministerial meeting on 6 May.

#### British Objectives

I agree with the conclusion of the report that it is in both this Department's interests and the wider national interest to seek the earliest possible termination of Government financing of in-service support for Concorde. The costs to the Government of providing continuing financial support for Concorde operations are certain to be incurred; the revenue offset from British Airways is very uncertain. There is a high probability that the cancellation options could be as attractive as any of the continuation options. Continuation with Federal Express in particular could lock the Government into funding support by the manufacturers for a long period of time. I believe that the risks that net public expenditure on continuation of Concorde will be greater than that on cancellation are sufficiently high to justify termination of support.

Moreover, our investigation of British Airways' own forecasts has not only confirmed the extreme sensitivity of the assumptions used but has also uncovered weaknesses in BA's



methodology and approach which lead me to place little confidence in their current assessments. I believe this situation will persist so long as the Government continues to fund in-support costs. Only when BA are faced with bearing all the costs are we likely to obtain a realistic indication of where the true balance of advantage lies. The Secretary of State for Trade may therefore wish to invite British Airways at the appropriate time to make their own decision on whether to continue operations; this would involve making their own arrangements with the manufacturers for support and negotiating with Federal Express on the basis that Government guarantees of continued support would not be available. Because of the absence of Government guarantees (an unacceptable, open-ended commitment for us), I would expect Federal Express to decide against continuation of their scheduled services.

#### French Objectives

These are not yet clear. The French may propose continuation as a means of testing our position. In that event I would propose to probe the French Government's own true intentions by insisting (a) on a satisfactory deal in cost sharing (see below) and (b) on joint exploration of the Federal Express option (to which we know the French Ministry of Finance is firmly opposed). The more likely French preference, however, is for cancellation.

A substantial reduction in Air France's services is already in prospect. Financial pressures on the French budget could lead to their complete withdrawal by the end of the year. If Air France services are terminated the French Government will no longer have any domestic reason for financing French manufacturers. Should the French Government decide on termination to save money they are unlikely to entertain British claims on cost sharing. Because French expenditures on termination will be significantly less than British expenditures, we can expect the French to argue that each party should pick up its own costs of rundown and termination. Such an approach would, according to our legal advice, be contrary to the letter and spirit of the 1962 Agreement. But this will not necessarily stop the French from trying to walk away from their Treaty obligations, if necessary by means of unilateral termination. I have registered our claims to an equitable solution on cost sharing in a recent letter to the French Minister. Firmness and persistence will be needed to make our claims stick but the outcome must be uncertain.

#### Reply to Select Committee Report

This is due by 24 April. I attach an essentially holding draft for my colleagues' approval, and also an explanatory note with whose recommendations I agree.



### Timing Considerations

To avoid undermining our negotiating position we need to maintain strict security within Government. We should give no forewarning to British Airways, or to the manufacturers, of any intention to withdraw Government support; but, if a decision in this sense is taken, it should be implemented at the earliest practicable date after negotiations, taking account of British Airways' intentions.

### Points for Decision

I accordingly invite my colleagues:-

a To concur that the UK's underlying objective in the negotiations should be to secure the earliest possible termination of Government financing of in-service support. We should seek ultimately to secure termination of in-service support on an agreed basis and as a simultaneous decision of the two Governments.

b To avoid any public comment about our views on the future of Concorde before the Anglo-French meeting. At the meeting, for tactical reasons and to secure the best possible deal on cost sharing, our initial position should be that we consider that on balance the evidence points in favour of British continuation.

c To authorise me to negotiate with M Fiterman accordingly; and should he propose withdrawal by mutual agreement to agree to consider this without commitment and subject to his producing tangible indications of French good faith by negotiating a satisfactory settlement on cost sharing. Should the French, contrary to present expectations, persist in arguing for continuation, I should, of course, seek further guidance from colleagues.

d To approve my proposed reply to the Select Committee Report.

Finally, we need to take decisions in the week beginning 19 April to enable British and French officials to make final preparation for the Ministerial meeting on 6 May.

I am copying this letter and enclosures to the Prime Minister, the members of E(EA), to John Biffen, Douglas Hurd, Tom Trenchard and Michael Jopling and to Sir Robert Armstrong.

*Yours a*  
Norman

NORMAN LAMONT

SECRET



10 DOWNING STREET

*File*

*2* *dfg*  
*cc Members of E(EA)*  
*+ Defence*  
*FLO*

From the Private Secretary

13 April 1982

THE FUTURE OF CONCORDE

The Prime Minister has seen Mr. Lamont's letter of 8 April to the Chairman of E(EA) about the future of Concorde.

Subject to the views of colleagues, she would be content with the decisions proposed in Mr. Lamont's letter.

I am sending copies of this letter to Jonathan Spencer in your Secretary of State's Office, and to David Wright (Cabinet Office).

M. A. PATTISON

John Alty, Esq.,  
Minister of State's Office,  
Department of Industry.

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SECRET

GOVERNMENT REPLY TO SELECT COMMITTEE'S  
SECOND REPORT ON CONCORDE

Report to the Minister of State for Industry

1. The Select Committee on Industry and Trade published a second report on Concorde on 25 February 1982 (Second Report from the Industry and Trade Committee Session 1981-82 Concorde HC 193). This note, and the draft reply attached, analyses for Department of Industry Ministers and the other members of the E(EA) Committee the substance of the Committee's report, and indicates the reasons for replying to it in the way suggested

Timing and Form of Reply

2. Under the general procedures applying to Select Committee reports the Government's reply should be given within two months of the report's publication, ie by 24 April. On the assumption that the E(EA) Committee meet on 19 April to consider Concorde matters generally and to approve the reply, this should be just about feasible.

3. However the Government traditionally has some latitude in replying to such reports (the reply to the Committee's first report on Concorde was presented to Parliament three months afterwards). The determining factor in this case is the impending Anglo-French Ministerial meeting on Concorde now arranged for 6 May. The outcome of this meeting is, and is likely to remain, highly uncertain. A Government reply made before the meeting, on the lines of the attached draft, could however be quite straightforward and phrased in such a way as not to prejudice the forthcoming negotiations.

4. In this connection the form of the Government's reply is also relevant. The report is too insubstantial to warrant a White Paper reply (as with the first report); and the Clerk has suggested that, in this instance, the reply could appropriately take the form of a letter from the Minister for Industry to the Chairman of the Committee. The letter would be evidence to the

Committee; and it would be for the Committee to decide if, when and in what manner to publish it.

5. If, however, E(EA) were to decide that the Government's reply were best made after the Anglo-French Ministerial meeting, rather than shortly before it, it might be possible to include that reply in whatever statement the Minister were to make to the House on the outcome of his meeting with the French Minister of Transport. However, this might not be desirable if the meeting is inconclusive, or the prelude to further intergovernmental negotiations (both of which seem possible), and this were to be reflected in a somewhat bland and unspecific statement.

6. Our preference is therefore for a reply to be given before the meeting, as carrying the lowest risks and being within the two months period; and, despite the restrictions on publication, for this to be done in the form of a letter to the Committee Chairman along the lines of the attached draft.

#### The Committee's Report

7. In contrast to the Department's memorandum of 2 December 1981, which the Committee recognise as having transformed the previous picture, the Committee's report adds little to what has been said previously. The principal features are:-

- (a) The Committee query the assumptions used in compiling the figures, and make whatever they can of the admitted uncertainties in forecasts of this kind (this constitutes the bulk of the report).
- (b) They assert that much more effort needs still to be made to ensure that the British taxpayer does not have to provide more money (paragraph 21).
- (c) They recommend (paragraph 22(a)) that, in agreement with the French, figures should be drawn up and published showing the balance of advantage

at the earliest date recognised as practicable for cancellation, and that a terminal date for support from public funds should be fixed and announced (paragraph 22(b)).

- (d) They recommend (paragraph 22(c)) that HMG should take the earliest opportunity of negotiating in detail with the French Government the implementation of the 1962 cost sharing agreement in letter and in spirit.

#### The Government's Reply

8. While still critical, the thinness of the latest report suggests that the Committee, despite diligent searching, do not have too much more to say at this stage. The Government, in our view, should prolong this by keeping its reply low keyed and anodyne. This is particularly necessary now that the Anglo-French discussions and negotiations on the future of Concorde are about to enter a critical phase.

9. This in turn suggests that the reply should not seek to deal with the Committee's observations, but should concentrate on their recommendations. There are a number of inaccuracies in the former. But putting them right would require disproportionate attention being drawn to relatively detailed matters, and could lead to further fruitless exchanges. It should also be noted that, apart from one small aside, the Committee have not pursued, in their report, earlier suggestions that the substantial reductions now foreseen in Concorde net project expenditures had only been brought about because of the Committee's decision to inquire into Concorde finances, and that no evidence had been offered previously to indicate that there might be such sharp reductions in expenditure.

10. The recommendations are of a more positive character. That recommending a statistical exercise, to be conducted jointly with the French and presented to the House of Commons and to the French National Assembly (paragraph 22(a)), could not be implemented without seeking French agreement, and is not therefore

worth pursuing. By concentrating instead on fixing and announcing a terminal date for support from public funds (paragraph 22(b)), the draft reply sidesteps this and manages an informative response to the Committee's main concern, in which an assessment originally contained in the Department's memorandum of 2 December 1981 on the British possibilities is updated, and an indication given for the first time of the French possibilities. In accordance with past practice, the British Airways results are as estimated by the airline.

11. The reply to the Committee's final recommendation, that for negotiations with the French Government on cost sharing (paragraph 22(c)), also contains previously undisclosed information, both about the Government's general attitude to this matter, and about what is being done to achieve progress. Details of both aspects, and of the omissions in the Committee's report (to which reference is made in the draft reply), have already been reported to E(EA) in the exchange of correspondence between Mr Lamont and the Minister of State, Foreign and Commonwealth Office (Mr Douglas Hurd).

Department of Industry  
6 April 1982

DRAFT LETTER FROM MINISTER OF STATE FOR INDUSTRY TO  
CHAIRMAN OF SELECT COMMITTEE ON INDUSTRY AND TRADE

Industry and Trade Committee Report on Concorde

I am writing to let you have the Government's considered reply to the recommendations contained in the Committee's second report on Concorde (HC 193) which was published on 25 February last.

The Committee recommend (paragraph 22(a)) that, in agreement with the French, figures should be drawn up and published showing the balance of advantage at the earliest date recognised as practicable for cancellation. Paragraph 22(b) defines cancellation as requiring that a terminal date for support from public funds should be fixed and announced; and this forms the Committee's second recommendation.

As I explained to the Committee on 9 December joint Anglo-French studies were being carried out to compare the relative costs in the two countries of continuation of Concorde services and their termination. These have now been completed and a report made to the two Governments.

The calculations, using up-dated estimates of the project costs of support and revised airline operating forecasts provided by British Airways, agree with Table B of the Department of Industry's memorandum of 2 December 1981, in indicating that British Airways Concorde surpluses, as

estimated by the airline, would exceed estimated net project expenditures by 1984-85. They suggest too that this date might be advanced to 1983-84 if the airline were to lease aircraft to Federal Express for a transatlantic parcels service. The joint studies also indicate that there is no foreseeable possibility of Air France realising surpluses on their Concorde operations which might be such as to cover the French manufacturers losses in providing in-service support to Air France and British Airways.

I shall be discussing these studies with the French Minister of Transport, M Fiterman, on 6 May to reach conclusions on them. We shall also consider whether or not a terminal date should be set for support of Concorde from public funds in each country, and if so what the date should be.

At our meeting I shall seek to negotiate with M Fiterman a settlement of outstanding cost sharing imbalances, which forms the subject for the Committee's third recommendation (in paragraph 22(c)). I have already reminded him of my statement at our meeting on 29 October 1981 that the future of Concorde would not be settled satisfactorily without a just and equitable solution to the question of these imbalances. Lord Carrington also drew the attention of M Cheysson, the French Foreign Minister, to this question at their meeting on 15 March.

While I welcome the Committee's interest and support, I feel it only appropriate to draw your attention to the complexities surrounding this issue as I explained them in my answer to Mr McNally (Question 6), and to the constraints that I described in my answer to Mr Emery, as he then was, (Question 58), at the hearing on 9 December 1981.

## STUDIES ON THE FUTURE OF CONCORDE

Report to the Minister of State, Department of Industry

1. At their meeting on 30 November 1981, E(EA) Committee invited the Minister of State, Department of Industry, to arrange for his officials, in consultation with those of the Treasury, the Foreign and Commonwealth Office, the Department of Trade, the Scottish Office and, as necessary, other Departments, to evaluate the options of cancellation of Concorde from October 1982, early phased rundown of Concorde and continuing support for Concorde, taking into account the points made in discussion and in the Chairman's summing up; and to report by the beginning of March 1982. This report is submitted to the Minister of State in response to the Committee's request and as a basis for his own report to the Committee.

Studies Undertaken

2. The evaluation of the options for the future of Concorde has been undertaken by British officials within the framework of the following four exercises:

- The joint Anglo-French studies on the future of Concorde, commissioned by the British and French Ministers responsible for Concorde at their meeting on 29 October 1981.
- The examination of a number of aspects of the methods used in the above study by an interdepartmental economist's group, set up for the purpose.
- The purely British study of cancellation of Concorde from early October 1982 and of rundown and termination at a range of dates.
- A separate examination by the Department of Industry, in conjunction with the Ministry of Defence, of the future costs to Government of in-service support for Concorde.

Each of these studies has evaluated, as appropriate, the costs listed in the annex to this paper.

3. The joint Anglo-French studies on the future of Concorde considered the costs to the British and French public sectors of the following options:

Option 1: Continuation of Concorde services by British Airways and Air France at their present level.

Option 2: As Option 1, but with the lease of four aircraft to the US small parcels carrier Federal Express to operate a transatlantic service.

Option 3: Phased rundown and termination of services on 1 April 1984.

These studies evaluated the costs of each option, in terms of public expenditure in each country, over the period 1 April 1982 to 31 December 1988, on the basis of information supplied by the British and French manufacturers, British Airways and Air France. An agreed report has now been prepared by British and French officials.

4. The interdepartmental group of economists was set up to advise on a number of aspects of the method used in the British input into the Anglo-French studies with a view to their advice being taken into account in the presentation of these results to British Ministers. The group reported that:

- The costs of each option should be presented to Ministers primarily in terms of resource costs but the costs in terms of public expenditure should also be presented (the latter only are shown in the joint report on the Anglo-French studies and in memoranda to the Select Committee).
- The British Airway's forecast operating surpluses

in the two continuation cases should be replaced, in the results presented to Ministers, by figures based on a more conservative set of assumptions, which the group termed "the realistic case", (the joint report on the Anglo-French studies uses BA's own assumptions and figures).\*

- There was considerable doubt about British Airways' forecast of the expected increase in their subsonic revenues in the event of cancellation. The group considered that BA's forecast was too conservative. They noted that a small increase in the number of subsonic passengers, in addition to that assumed by BA, would significantly increase revenues from, and hence reduce the cost of, cancellation.
- That there was a small additional benefit both in resource cost and in public expenditure terms from locating the Federal Express European terminal at Prestwick as opposed to Shannon (the two sites proposed by Federal Express).

More generally, in presenting their report the group expressed serious reservations about using the information in the joint studies as the basis for a decision on the future of Concorde, in view of the sensitivity of the British Airways figures to small changes in assumptions. They noted that there was a high risk of an adverse outcome under each option.

5. The purely British study of cancellation on 1 October 1982 ("Option 4") has been carried out by officials, without consulting either the British manufacturers, British Airways or French officials. This study also considered, in broad terms only, the cost of rundown and termination at dates later than the date of 1 April 1984 used in the joint Anglo-French studies. The results of the purely British study have been prepared taking into account the comments of the group of economists on the joint Anglo-French studies. In particular they show both resource costs and public expenditure and adopt the

"realistic case" for British Airways results.

6. The separate examination by the Department of Industry and Ministry of Defence of the cost of continued support for Concorde over the period 1981-82 to 1985-86 has also been completed. It confirms that there is no scope for further significant economies in in-service support in addition to those implemented in the major review of costs undertaken in 1981, assuming Concorde services continue as at present.

#### Anglo French Aspects

7. In considering the future of Concorde, the Minister of State will wish to know the position shown in the joint Anglo-French studies of the costs to the French public sector of each of the options. In the French case there are considerable costs whichever option is adopted since the capital used to purchase Air France Concordes was largely raised commercially and repayments of interest and capital continue at least until 1988. The French results in the joint Anglo-French studies show that, including repayments of capital and interest up to 1988, Option 3, rundown and termination on 1 April 1984, is the least costly option.

8. In addition to the jointly studied options, we understand that French officials have studied two further options:

- A variant of Option 2 involving continuation but with cancellation of Air France's service to Mexico City and restriction of the Paris-New York service to seven flights per week, two of which would go on to Washington, plus the lease of aircraft to Federal Express.
- A variant of Option 3 involving termination of Air France services on 31 December 1982.

We believe that both these options would be less costly

than any of the options studied jointly but we do not know, of the two, which is the less costly.

9. We understand however that French Finance Ministry officials are strongly opposed to any lease of aircraft to Federal Express because this would lock the French Government into supporting Air France's losses for the seven year period of the guarantee. We also understand that French officials have been exploring not only the termination of Air France services from 31 December 1982 but also the cessation, possibly unilateral, of intergovernmental arrangements under the 1962 Agreement for the support of British Airways services from that date. The French manufacturers would however be free to continue to support British Airways Concorde, but would not receive funding to do so from the French Government.

10. We are unable to assess at this stage which of the three options jointly studied, or the two variants on them, French Ministers are likely to prefer. There would, of course, be serious difficulties in HM Government withdrawing financial support for Concorde if the French Government decided that they wished to continue with the project.

#### Evaluation of the Results

11. We accept the view of the economists group that resource costs are the conceptually correct way to evaluate the economic merits of each option. However we consider that Ministers, having evaluated those merits, would wish to consider the public expenditure implications of the choice, if any, those merits determine. Should the public expenditure costs prove to be significantly in excess of those of one of the other options, Ministers would undoubtedly wish to re-examine their earlier evaluation of the economic case. We therefore consider that both resource costs and public expenditure costs should be given equal prominence in presentation to Ministers. However we agree that the British Airways' Concorde operating surplus

presented should be that implied by more conservative "realistic case" assumptions, as proposed by the economists

12. Table A therefore sets out the resource costs and public expenditure implications of the options studied jointly by British and French officials (Option 1, 2 and 3) and of Option 4, cancellation on 1 October 1982, using the "realistic case" for British Airways Concorde operating results. This shows that in resource cost terms Option 2, continuation with Federal Express, is most attractive but that there is little to choose between the other options. The public expenditure figures also rank continuation with Federal Express as the most attractive option in terms of public expenditure, but show that both of the cancellation options are considerably more costly than continuation without Federal Express.

13. However, in evaluating these results, we are particularly mindful of the sensitivity of the results to changes in the assumptions about British Airways' Concorde and subsonic results and of the possibility that the costs of each option in practice could be considerably in excess of those shown. Option 1 carries with it the risk that, despite the more conservative assumptions used in these figures as compared to those supplied by British Airways, BA's Concorde operating surplus could be significantly less than now forecast. Option 2 carries the risk that, since Federal Express would only be prepared to go ahead in return for a guarantee of continued Government support for Concorde for a period of some seven years, the Government could be locked into funding support by the manufacturers for a long period of time. This could prove costly should an airworthiness problem require considerable additional expenditure to enable HMG to meet its guarantee. Options 3 and 4 carry with them the possibility that British Airways' subsonic results could be significantly better without Concorde, and hence that the costs of those options could prove less in practice than shown.

14. Whilst the forecast future revenues are open to considerable doubt, it is certain that significant expenditures on in-service support will continue to be needed over the next few years. In these circumstances we consider that the figures shown in Table A provide no clear policy prescription. This view is reinforced by the work on the costs of termination at dates later than 1 April 1984, which show no clear case for or against delaying termination. Moreover, we do not consider that further studies would make the overall position any more clear.

#### Views of Interested Departments

15. Since no clear picture emerges from consideration of the public sector overall, Departmental interests become important. Table B sets out those of the cost of each option which would fall in each year to be carried on the Department of Industry Vote whilst Table C sets out year by year the remaining public expenditure on Concorde. These tables show that the costs of each of the four options to the Department of Industry Vote are almost identical in 1982 and 1983 taken together, but that the two cancellation options are substantially cheaper than continuation over the whole period 1982-88. Indeed cancellation on 1 October 1982 is only just half as expensive as continuation without Federal Express (the current hypothesis used for PES and other purposes) over the whole period. Moreover, as has already been noted, we believe that these project support figures are inherently more reliable than the other elements of cost in view of the experience of forecasting built up by the manufacturers over the years and the good overall record of forecasting by the Department of Industry of expenditure on Concorde support in recent years (as opposed to a poor record for development and production costs in earlier years). Finally there are no reasons of Departmental aerospace, general industrial, or other policy for supporting continued expenditure on Concorde.

16. In these circumstances DoI recommend that the Minister of State should ask his colleagues to agree to termination of Government funding for support for Concorde by the British manufacturers at the earliest practicable opportunity. The precise timing of the termination of support will depend partly on what the French want to do and partly on whether British Airways wish to continue Concorde services and fund in-service support themselves. We recommend, however, that there should not be a protracted period before termination and therefore envisage that support would be terminated some time in the period 1 October 1982 to 31 March 1983. Faced with such a recommendation it would be for Ministers collectively to determine the Government's policy on the future of Concorde. It should be reiterated that termination of Government support need not mean an end to Concorde services if BA were prepared and in a position to meet the future costs of support by the manufacturers. In principle BA ought to be able to make a better informed and more realistic decision about where the true balance of advantage lies when faced with all the costs of continued operation of Concorde, in contrast to the present position in which it bears only some of these. However in practice there must be strong doubts if BA would continue Concorde without Government support.

17. The Treasury supports the Department's view. The cost savings imply a release of real resources which can be used more productively elsewhere in the economy. These resource savings are of long term benefit to the economy, helping to strengthen its underlying competitiveness. It may be that in the short run the public financing costs of closure will exceed these real resource savings adding therefore to the public sector borrowing requirement (PSBR). These costs are mainly transfer payments and include severance costs, higher unemployment outgoings and losses of revenue. They are once for all or in time will diminish as the released resources are re-absorbed into the economy. In the Treasury view a short term worsening of the PSBR is acceptable if the alternative is to incur real resource costs

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on a continuing basis with the consequence that the economy is denied the economic benefit which might follow if these resources were diverted into more productive use. The Treasury also shares the Department's doubt about the proposition that British Airways would be able to operate future Concorde services at a profit and that it would fail to pick up more than the small fraction of existing Concorde passengers on its existing subsonic services. Moreover, the Treasury notes that whereas the project costs of continuation can be estimated with reasonable confidence the revenue offsets calculated by British Airways are highly uncertain. The Treasury also notes that on some scenarios the public expenditure costs of early cancellation could exceed those of continuation. However it considers that a Federal Express service is so uncertain a prospect that it should not affect the decision. The comparison should be between early cancellation and continuation without Federal Express.

18. FCO officials have no substantive comment to make on the industrial case for or against Concorde, and are principally concerned with the implications for our relationship with the French. If Ministers agree that British Government funding should be terminated, the interests of the two Governments would appear to coincide. But the FCO see the negotiation on termination as being the only realistic opportunity to reach a settlement of the cost sharing problem, and therefore believe that it would be prudent to maximise our bargaining strength by giving no indication at this stage that we might see advantage in termination (as the Anglo-French studies indicate). The FCO's preliminary view is that the French would not be entitled unilaterally to withdraw Government support from the project if the negotiations break down. This point and negotiating tactics generally, will, however, need to be considered carefully by the FCO before the meeting with M. Fiterman.

19. There are three aspects to the Department of Trade's interest in the future of Concorde:-

- (i) As potential beneficiaries of the 80 per cent/20 per cent profit sharing arrangement with British Airways - on the basis of the estimates in this paper BA will not make good accumulated losses and become due to make payments until about 1985;
- (ii) As sponsors of the UK airline industry and of British Airways in particular - Concorde is forecast to contribute about 3 per cent of BA's revenue and 4½ per cent of their operating profits in 1982/83 (proportions which are expected to decline in later years); and
- (iii) As future vendors of British Airways' shares to the public.

The Department accept that there is considerable uncertainty about BA's forecast Concorde operating results (which BA have seriously over-estimated in the past), and that this uncertainty must be reflected in the decision on Concorde's future. However, this decision, as well as taking account of the quantifiable costs and benefits of the various options to the UK economy and to the Exchequer, will need also to reflect a judgement on the effect of Concorde on the competitive position of BA, both now and when privatised, in the world travel market. DoT Ministers will wish therefore to weigh up the significance of Concorde in the UK civil aviation policy when reaching a view on the withdrawal of Government support for the project.

20. British Airways themselves are quite likely to oppose a decision to end Government support for Concorde; they may even campaign publicly for its continuation, claiming that without it they will not be able to maintain Concorde in service. Ministers will therefore be held responsible not only for withdrawing Government support, but also for grounding the aircraft; and they will need to be able to explain publicly why both are in the national interest.

21. If British Aerospace were to become aware that HMG might take a decision to withdraw financial support which would lead to termination of Concorde services in the near future, the negotiations by MOD of HMG's claim against BAe in respect of Concorde spares destroyed by fire at Weybridge in 1980 would be adversely affected. The claim is being assessed on the basis of the replacement cost of the lost spares, and that cost is dependent on the spares actually being replaced. If Concorde ceases to operate most of the spares would not need to be replaced and the amount of the claim would be assessed by reference to the value to HMG of the spares as they were on the shelf at the time of the fire. That value is essentially the potential sales value, but if Concorde services are terminated and there is no sales outlet for the spares their destiny becomes the scrapheap. Thus the value of HMG's claim would be only the scrap value of the lost spares, because that is all HMG would have obtained for them. Quantifying the devaluation of HMG's claim on this account is extremely hazardous. But, taking into account MOD(PE)'s current legal advice that HMG could not expect to recover or retain more than its true loss, the best indication which can be given is that it could be reduced by as much as £20M, or by as little as £15M, depending on negotiations.

22. The Department of Employment advise that the majority of jobs which would be lost if BA felt unable to take over financial responsibility for Concorde are located in the relatively buoyant labour markets of Bristol and the South East. On the other hand, the Rolls Royce workers at Coventry face a rather more bleak immediate future if made redundant. The unemployment rate there is currently 15.6 per cent though this shows a slight fall from the January 1982 rate of 16 per cent. By the time Concorde workers begin to be laid off (October 1982) it is possible that some improvement in the underlying economy of the area will enhance the job prospects of the highly skilled ex Concorde workers.

23. The concern of the Scottish Office has been to ensure that, if Option 2 were to be chosen, Prestwick should be the European hub for the Federal Express parcels operation. The Scottish Office do not, however, regard the additional benefit accruing from the use of Prestwick as a determining

factor in Ministers' decision on the options before them and do not, therefore, dissent from the conclusion in para 14 above.

Further Action

24. Once the Minister of State has reached a view on the recommendations in this report we suggest that he should circulate it under cover of a note setting out his own views, to his E(EA) and other colleagues, for subsequent discussion and decision by Ministers collectively. A meeting of E(EA) needs to take place in the week beginning 19 April if officials are to have time to advise Ministers, in the light of their decision on the future of Concorde and of the latest information about the preferred French option, on the tactics the Minister of State should adopt at his meeting, expected on 6th May, with the French Minister for Transport. Ministers may well need to meet again to consider this advice sufficiently early in the week beginning 26 April, the week before the proposed Anglo-French meeting, to allow preliminary discussions to take place between British and French officials should these be considered desirable.

DEPARTMENT OF INDUSTRY  
8th APRIL 1982

## COSTS EVALUATED IN CONCORDE STUDIES

Resource Costs

1. In all options, Department of Industry expenditure on in-service support by British manufacturers.
2. In the event of termination, Department of Industry expenditure under its contracts with the manufacturers for compensation for lost profit and contribution to overheads, less an allowance for sale of redundant parts and materials.
3. In all options, British Airways Concorde operating results.
4. In the case of termination, the additional fixed costs incurred on BA's subsonic services, arising as a result of cancellation of Concorde.
5. In the case of termination, the increase in British Airways' subsonic revenues from carrying passengers who would otherwise have flown Concorde.

Public Expenditure

1. All the above resource costs plus:
2. In each case, the cost to HMG of severance costs at the manufacturers arising from a reduction in Concorde work.
3. In each case, any severance costs in respect of Concorde employees of British Airways.
4. In each case, the "other public sector costs" comprising the loss to the Exchequer in reduced income tax and national insurance contributions and increased payments of unemployment and supplementary benefit payments, arising from the reduction in that case in Concorde employment.

CONCORDE: NET COSTS AND BENEFITS

RESOURCE COSTS IN £M, DISCOUNTED AT 5%, AT SEPTEMBER 1981 PRICES

| Option and case<br>Year | Option 1<br>Continuation without Federal Express | Option 2<br>Continuation with Federal Express | Option 3<br>Rundown and Termination on 1.4.84 | Option 4<br>Cancellation on 1.10.82 |
|-------------------------|--|---|---|-------------------------------------|
| 1982                    | (10.2)   | (10.2)  | (11.1)  | (15.0)                              |
| 1983                    | (8.5)  | (7.2) to (6.7)                                | (5.3)   | (7.2)                               |
| 1984                    | (2.3)  | 0.9 to 2.4                                    | (2.6)   | (1.8)                               |
| 1985                    | 0.9  | 4.1 to 5.6                                    | (3.5)   | 2.7                                 |
| 1986                    | 2.0  | 5.0 to 6.5                                    | 1.3   | 2.8                                 |
| 1987                    | 3.5  | 6.9 to 8.4                                    | 3.1   | 3.1                                 |
| 1988                    | 3.3  | 6.9 to 8.4                                    | 3.1   | 3.1                                 |
| NPV                     | (12.7)   | 1.6 to 8.2                                    | (15.7)  | (14.1)                              |

PUBLIC EXPENDITURE COSTS UNDISCOUNTED IN £M, AT SEPTEMBER 1981 PRICES

| Option and case<br>Year | Option 1<br>Continuation without Federal Express | Option 2<br>Continuation with Federal Express | Option 3<br>Rundown and Termination on 1.4.84 | Option 4<br>Cancellation on 1.10.82 |
|-------------------------|--|---|---|-------------------------------------|
| 1982                    | (10.2)   | (10.2)  | (12.5)  | (30.5)                              |
| 1983                    | (10.2)   | (8.8) to (8.3)                                | (8.1)   | (15.9)                              |
| 1984                    | (3.6)  | (0.4) to 1.1                                  | (10.1)  | (7.7)                               |
| 1985                    | (0.2)  | 3.0 to 4.5                                    | (11.6)  | (0.6)                               |
| 1986                    | 1.4  | 4.4 to 5.9                                    | (1.8)   | 2.6                                 |
| 1987                    | 2.5  | 5.9 to 7.4                                    | 2.3   | 3.0                                 |
| 1988                    | 2.8  | 6.4 to 7.9                                    | 3.0   | 3.1                                 |
| TOTAL                   | (17.5)   | 0.3 to 8.3                                    | (38.8)  | (46.0)                              |

- Notes: (1) 1 April 1982 to 31 December 1982 only.  
(2) Amounts in brackets are costs/expenditures, other amounts are revenues/receipts.

EXPENDITURE ON CONCORDE CARRIED ON DEPARTMENT OF INDUSTRY VOTE<sup>(2)</sup>  
IN £ M AT SEPTEMBER 1981 ECONOMIC CONDITIONS

|                     | Option 1<br>Continuation<br>without Federal<br>Express | Option 2<br>Continuation<br>with Federal<br>Express | Option 3<br>Rundown and<br>termination<br>on 1.4.84 | Option 4<br>Cancellation<br>on 1.10.82              |
|---------------------|--|---|---|---|
| 1982 <sup>(1)</sup> | (14.3)   | (14.3)  | (16.1)  | (23.5)  |
| 1983                | (14.4)   | (14.5)  | (12.1)  | (3.5)   |
| 1984                | (8.3)  | (7.4)   | (2.6)   | 0.3   |
| 1985                | (4.5)  | (3.8)   | (2.4)   | 0.0   |
| 1986                | (3.1)  | (2.6)   | 0.2   | 0.1   |
| 1987                | (0.8)  | 0.1   | 0.4   | 0.4   |
| 1988                | (0.1)  | 1.0   | 0.4   | 0.4   |
| TOTAL               | (45.5)<br>of which (28.7)<br>in 1982 and<br>1983       | (41.5)<br>of which (28.8)<br>in 1982 and<br>1983    | (32.2)<br>of which<br>(28.2) in<br>1982 and<br>1983 | (25.8)<br>of which<br>(27.0) in<br>1982 and<br>1983 |

Notes: (1) 1 April 1982 to 31 December 1982 only.

(2) Expenditure comprises net project costs for all options plus contractual costs of cancellation and project severance costs for options 3 and 4.

(3) Amounts in brackets are expenditures, other amounts are receipts.

PUBLIC EXPENDITURES ON CONCORDE<sup>(2)</sup> OTHER THAN THAT CARRIED ON  
DEPARTMENT OF INDUSTRY VOTE IN £M AT SEPTEMBER 1981 ECONOMIC CONDITIONS

|                     | Option 1<br>Continuation<br>without Federal<br>Express     | Option 2<br>Continuation<br>with Federal<br>Express                        | Option 3<br>Rundown and<br>termination<br>on 1.4.84         | Option 4<br>Cancellation<br>on 1.10.82                          |
|---------------------|--|--|---|---|
| 1982 <sup>(1)</sup> | 4.1  | 4.1  | 3.6   | (7.0)   |
| 1983                | 4.2  | 5.7 to 6.2   | 4.0   | (12.4)  |
| 1984                | 4.7  | 7.0 to 8.5   | (7.5)   | (8.0)   |
| 1985                | 4.3  | 6.8 to 8.3   | (9.2)   | (0.6)   |
| 1986                | 4.5  | 7.0 to 8.5   | (2.0)   | 2.5   |
| 1987                | 3.3  | 5.8 to 7.3   | 1.9   | 2.6   |
| 1986                | 2.9  | 5.4 to 6.9   | 2.6   | 2.7   |
| TOTAL               | 28.0<br>of which<br>revenues of 8.3<br>in 1982 and<br>1983 | 41.8 to 49.5<br>of which<br>revenues of 9.8<br>to 10.3 in 1982<br>and 1983 | (6.6)<br>of which<br>revenues of<br>7.6 in 1982<br>and 1983 | (20.2)<br>of which<br>costs of<br>(19.4) in<br>1982 and<br>1983 |

Notes: (1) 1 April 1982 to 31 December 1982 only.

(2) Comprises all BA costs and revenues, the project severance costs met by HMG from the Redundancy Fund under Options 1 and 2 and other public sector costs (lost taxation and national insurance revenues and increased supplementary and unemployment benefit payments).

(3) All amounts are receipts except where indicated by brackets.

## BRITISH AIRWAYS RESULTS

1. This addendum sets out, at the request of the Minister of State, the British Airways component of the costs of each of the options set out in the main paper.
2. Table 1 sets out the British Airways Concorde operating result for option 1, continuation without Federal Express, as implied by the more conservative "realistic" set of assumptions proposed by the interdepartmental group of economists. There is a clear risk that British Airways results could be worse than those in the table, particularly in view of the recent downward revision in British Airways' forecast Concorde operating result for 1981/82 which was not taken into account by the economists.
3. Table 2 sets out British Airways Concorde costs and revenues arising under option 2, continuation with Federal Express. The operating surplusses on scheduled services are somewhat higher than in the case of option 1 since it is assumed that a proportion of the fixed costs of those services would be borne by Federal Express. Nevertheless the risks referred to for option 1 also apply to these results. The lease rental and contribution to fixed costs from Federal Express which are shown are subject to the outcome of negotiation with Federal Express but are as at present proposed by British Airways and Federal Express. It is intended that Federal Express should be required to obtain a third party guarantee for payment of their lease rental but no such proposal has yet been put to them. For their part, Federal Express have said that they would require a guarantee of support from the British and French Governments for a period of seven years and that they would be prepared to offer counter guarantees. Should an airworthiness problem arise during that seven year period it could require considerable extra expenditure to correct if HMG were to meet its obligations under such a guarantee. Should Federal Express wish to cease operations during the seven year period, whatever the position about lease rentals, British Airways would lose the contribution by Federal Express to its Concorde fixed costs and the costs of its scheduled services would be increased by the amount of fixed costs formerly attributed to Federal Express. The range for the estimated loss of cargo revenue is that provided by BA. The view of the group of economists was that, BA may have over estimated this loss and that therefore a loss at the lower end of the range was more likely.

4. Tables 3 and 4 set out the costs and revenues to BA of the cancellation options 3 and 4, involving cancellation on 1 April 1984 and 1 October 1982 respectively. The Concorde operating results shown up to the dates of termination are as for the case of continuation without Federal Express. The fixed costs of Concorde continuing after rundown are those fixed costs a portion of which is at present attributed to Concorde but which after termination of Concorde services would have to be borne entirely by BA's subsonic services. BA estimate that after a period of two years from termination their subsonic services would have grown sufficiently to absorb fully these costs. It is difficult to estimate the accuracy of BA's assessment of the continuing fixed costs but it is interesting to contrast their view with that taken by Air France, whose Concorde operation is of a similar size to BA's, that their continuing fixed costs would be at about one quarter of the BA level and would be eliminated within six months of termination. The improvement in BA's subsonic result derives from the increased traffic BA would expect to carry once the alternative of Concorde was no longer available. They estimate that some 9% of Concorde passengers would transfer to their subsonic services. The economists' group regarded this assumption as conservative but did not provide an alternative assumption since BA were not able to provide them with a coherent explanation of what they expected to happen to subsonic traffic in the event of cancellation of Concorde. They pointed out however that one extra first class subsonic passenger in each direction would reduce the cost of termination by almost £ $\frac{1}{2}$ m for each year after termination. Finally, for option 4, cancellation on 1 October 1982, the figures in table 4 include severance costs in respect of almost all of BA's Concorde workforce. They are expected to be made redundant in the event of termination at short notice. On the other hand in the case of rundown and termination on 1 April 1984 BA expect to be able to shed or redeploy all these employees before the date of termination and say that therefore, no severance costs arise.

Table 1

Option 1: British Airways Concorde Operating Results (Realistic Case)

| <u>Year</u>         | <u>Surplus in £M (September 1981 Economic Conditions)</u> |
|---------------------|---|
| 1982 <sup>(1)</sup> | 4.1   |
| 1983                | 5.9   |
| 1984                | 6.0   |
| 1985                | 5.4   |
| 1986                | 5.1   |
| 1987                | 4.3   |
| 1988                | <u>3.4</u>  |
| <u>Total</u>        | <u>34.2</u>   |

Note: (1) 1 April 1982 to 31 December 1982

Table 2

Option 2: British Airways Costs and Revenues (Realistic Case)

Amounts in £M at September 1981 Economic Conditions

| <u>Year</u>         | <u>Operating Result: Scheduled Services</u> | <u>Lease Rental From Federal Express</u> | <u>Federal Express Contribution to Fixed Costs</u> | <u>Fixed Costs Attributable to Federal Express</u> | <u>Lost Cargo Revenue With Federal Express</u> | <u>Net Total</u>    |
|---------------------|---|--|--|--|--|---------------------|
| 1982 <sup>(1)</sup> | 4.1   | -  | -  | -  | -  | 4.1                 |
| 1983                | 6.8   | 1.6                                      | 0.7  | (0.6)  | (1.2) to (0.7)                                 | 7.3 to 7.8          |
| 1984                | 7.7   | 4.3                                      | 1.6  | (1.9)  | (3.4) to (1.9)                                 | 8.3 to 9.8          |
| 1985                | 7.3   | 4.3                                      | 1.6  | (1.9)  | (3.4) to (1.9)                                 | 7.9 to 9.4          |
| 1986                | 7.0   | 4.3                                      | 1.6  | (1.9)  | (3.4) to (1.9)                                 | 7.6 to 9.1          |
| 1987                | 6.2   | 4.3                                      | 1.6  | (1.9)  | (3.4) to (1.9)                                 | 6.8 to 8.3          |
| 1988                | 5.3   | 4.3                                      | 1.6  | (1.9)  | (3.4) to (1.9)                                 | 5.9 to 7.4          |
| <u>Total</u>        | <u>44.4</u>                                 | <u>23.1</u>                              | <u>8.7</u>   | <u>(10.1)</u>                                      | <u>(18.2) to (10.2)</u>                        | <u>47.9 to 55.9</u> |

Note: (1) 1 April 1982 to 31 December 1982

Table 3

Option 3: British Airways Costs and Revenues (Realistic Case)

Amounts in £M at September 1981 Economic Conditions

| <u>Year</u>         | <u>Concorde<br/>Operating<br/>Result</u> | <u>Fixed<br/>Costs<br/>Continuing<br/>after<br/>Termination</u> | <u>Increased<br/>Subsonic<br/>Revenues</u> | <u>Net<br/>Total</u> |
|---------------------|--|---|--|----------------------|
| 1982 <sup>(1)</sup> | 4.1                                      | -   | -  | 4.1                  |
| 1983                | 5.9                                      | -   | -  | 5.9                  |
| 1984                | 1.5                                      | (4.8)   | 2.0  | (1.3)                |
| 1985                | -  | (6.4)   | 2.7  | (3.7)                |
| 1986                | -  | (1.6)   | 2.7  | 1.1                  |
| 1987                | -  | -   | 2.7  | 2.7                  |
| 1988                | -  | -   | 2.7  | 2.7                  |
| Total               | <u>11.5</u>                              | <u>(12.8)</u>   | <u>12.8</u>                                | <u>11.5</u>          |

Note: (1) 1 April 1982 to 31 December 1982

Table 4

Option 4: British Airways Costs and Revenues (Realistic Case)

Amounts in £M at September 1981 Economic Conditions

| <u>Year</u>         | <u>Concorde<br/>Operating<br/>Result</u> | <u>Fixed<br/>Costs<br/>Continuing<br/>after<br/>Termination</u> | <u>Increased<br/>Subsonic<br/>Revenues</u> | <u>Severance<br/>Costs</u> | <u>Net<br/>Total</u> |
|---------------------|--|---|--|----------------------------|----------------------|
| 1982 <sup>(1)</sup> | 2.8                                      | (1.6)   | 0.7  | (8.9)                      | (7.0)                |
| 1983                | -  | (6.4)   | 2.7  | -                          | (3.7)                |
| 1984                | -  | (4.8)   | 2.7  | -                          | (2.1)                |
| 1985                | -  | -   | 2.7  | -                          | 2.7                  |
| 1986                | -  | -   | 2.7  | -                          | 2.7                  |
| 1987                | -  | -   | 2.7  | -                          | 2.7                  |
| 1988                | -  | -   | 2.7  | -                          | 2.7                  |
| Total               | <u>2.8</u>                               | <u>(12.8)</u>   | <u>16.9</u>                                | <u>(8.9)</u>               | <u>(2.0)</u>         |

Note: (1) 1 April 1982 to 31 December 1982