Treasury Chambers, Parliament Street, SW1P 3AG

Kenneth Baker Esq MP
Minister of State
Department of Industry
Ashdown House
123 Victoria Street
London SW1

9 September 1981

METRO-CAMMELL LIMITED: KOWLOON-CANTON RAILWAY

Thank you for your letter of 14 August in which you proposed that Metro-Cammell be allowed to take out backdated cost escalation cover for the cash contract which it is negotiating with the Kowloon-Canton Railway. I entirely agree with John Biffen's conclusions, set out in his letter of 1 September, that it would not be acceptable to use the CEC scheme, which is intended to operate as a viable insurance facility, to provide a subsidy through retrospective insurance where a claim would be certain to arise.

I understand that as a result of Treasury officials initially rejecting this proposal, informal discussions with the Kowloon-Canton Railway began on the possibility of credit, incorporating interest subsidies, being offered as a means of obtaining their agreement to an increased price. The cost of providing interest subsidies may well exceed the subsidy requested under the Cost Escalation Cover scheme. If the latter subsidy is regarded as the amount necessary to obtain the contract, it does not seem sensible to provide a greater subsidy through an alternative route in order to obtain the contract.

I would prefer that this contract be seen in relation to the second contract mentioned in your letter which Metro-Cammell wishes to obtain in Hong Kong from the Mass Transit Railway. There is clearly an inter-relationship between the two contracts since if the subsidy requested for the first contract is granted but not the subsidy for the second, Metro-Cammell appears unlikely to obtain sufficient work to tide itself over until it obtains new orders from London Transport. On the other hand if a subsidy is provided for the second contract but not the first and Metro-Cammell loses the first contract Hong Kong would no longer be such an effective showpiece for the company.

I understand that the Industrial Development Unit has in fact already started an appraisal for the use of the Industry Act to assist Metro-Cammell on the second contract. If no subsidy is provided for the first contract and this contract is accepted on a loss-making basis this loss could be incorporated in the appraisal undertaken by the Industrial Development Unit of the company and the contracts. I would hence prefer to defer a decision on the provision of any subsidy to Metro-Cammell until the Industrial Development Unit has reported.

I should however record at this stage my increasing concern about the number of applications received from exporters for subsidies of various forms to assist them in obtaining specific overseas contracts. In this case, the subsidy requested is to enable Metro-Cammell to continue its operations. It should be seen as much in the context of a domestic industrial subsidy as an export subsidy and will have to be justified in part on these grounds.

I am copying this letter to the recipients of yours.

LEON BRITTAN

DEPARTMENT OF TRADE 1 VICTORIA STREET LONDON SW1H 0ET Telephone 01-215 7877 2.

PM. Hong Kong

Prime Minister

There may now have to be collective discussion. But I doubt whether you need be involved.

MAP 1/IX

From the Secretary of State

MS

The Rt Hon Leon Brittan QC MP
Chief Secretary
HM Treasury
Treasury Chambers
Parliament Street
London, SW1P 3AG

1 September 1981

Dear Chief Secretary

I have seen Kenneth Baker's attached recent letter to you about the £17 million order which Metro-Cammell Limited are pursuing for rolling stock for the Kowloon-Canton Railway in Hong Kong. I appreciate the importance of additional business to the company's future; it would be a pity if, because they were unable to negotiate this order as a supplement to the existing contract, it ended up going to the Japanese in an international bidding situation. However, I have to inform you of my conclusion, after discussion with my officials and legal advisers, that what is proposed would not represent a proper use of the relevant part of ECGD's Act.

The suggestion is that the Act be used to provide retrospective cost escalation cover (CEC), going back no less than three years. The scheme has always been represented to Parliament, both by our predecessors and by the present Government, as providing insurance against the unpredictabilities of future inflation levels. Last March Cecil Parkinson, in moving the scheme's extension to 1982, re-emphasised the Government's objective to make it viable and self-financing. It is also relevant to note here the assurance given to the House by our predecessors, that CEC would not be used to provide special assistance to firms facing difficulties for employment or viability reasons.

If the existing contract had included specific provision for the supply of these additional trains, perhaps in the form of an option, it might have been possible to act as Kenneth has proposed. But it did not and

From the Secretary of State

I am convinced that in all the circumstances it would not be reasonable to treat the current request as if it had been made three years ago when the existing contract was negotiated. Equally I do not believe that it would be a correct use of the power which Parliament has enacted if my Department were to provide an outright subsidy by giving CEC on the retrospective basis requested. To do so would, moreover, be at odds with the basis on which we have defended it in GATT and other international fora critical of such schemes.

I am copying this letter to the recipients of his.

11 SEP 1981

Yours sincerely,

JOHN BIFFEN

(Approved by the Secretary of State and signed in his absence.)

DEPARTMENT OF TRANSPORT
2 MARSHAM STREET LONDON SW1P 3EB

The Rt Hon Leon Brittan QC, MP
Chief Secretary to the Treasury
Treasury
Parliament Street
LONDON SW1

28 August 1981

Dear Leon,

I have seen Kenneth Baker's letter to you of 14 August about an extension of Cost Escalation Cover for Metro Cammell's contract to supply rolling stock for the Kowloon-Canton Railway.

I am writing to support Kenneth's view of the serious situation which would arise for Metro Cammell if they cannot secure extension of the cover. As he says, after 1983 there is a 6 year gap before London Transport are likely to be able to place rolling stock orders with Metro Cammell again. It would be extremely unfortunate if, because cover is not extended, Metro Cammell went out of business and London Transport - and any other UK purchasers - had to turn to overseas suppliers. So this contract could be crucial and I join with Kenneth in urging you to agree to Metro Cammell's request.

Yours Norman

NORMAN FOWLER

File

DSG

28 August 1981

Thank you for your letter of 27 Aggust providing some background information about Metro-Cammell in the context of the proposal for support for their orders from Hong Kong.

The Prime Minister was grateful for this inforaation.

M. A. PATTISON

Jonathan Hudson Esq
Department of Industry

COMMERCIAL IN CONFIDENCE

2

DEPARTMENT OF INDUSTRY
ASHDOWN HOUSE
123 VICTORIA STREET
LONDON SW1E 6RB
TELEPHONE DIRECT LINE 01-212 6401
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FROM THE
MINISTER OF STATE
FOR INDUSTRY AND
INFORMATION TECHNOLOGY

Kenneth Baker's Office

27 August 1981

Prime Minister
–
MAP 27/VIII

Mike Pattison Esq
Private Secretary
10 Downing Street
London SW1

Dear Mike,

The Prime Minister asked about the level of Metro-Cammell's wage settlement in the context of support for their orders from Hong Kong.

I attach a note setting out the details. Briefly, the supervisory and some white collar staff have settled for 5%. The direct labour force were given 8% in August last year but the offer for this year is zero. In the last year productivity has increased by 8.75%.

Yours ever,

Jonathan Hudson

JONATHAN HUDSON
Private Secretary

Thank you
MT.

COMMERCIAL IN CONFIDENCE

Reference.....................................

Mr Hudson
PS/Mr Baker

RECEIVED IN
24 AUG 1981
OFFICE OF THE
MINISTER OF STATE
KENNETH BAKER

cc Mr Dell o.r.
Mr Pride o.r.

METRO-CAMMELL LTD - WAGE SETTLEMENTS, PRODUCTIVITY AND COSTS

I understand the Prime Minister expressed interest in the above. You may like to have the following information.

i) Wage settlements

After a long struggle, but without "industrial action" being taken, the company had succeeded in obtaining agreements for a 5% wage increase for the following non-operative classes:-

1 January	ASTEMS	(foremen)
1 May	APEX	(clerical staff)
1 June	TAFF	(draughtsmen)

Metro- Cammell operates piece-work rates for their directly employed labour force and on 17 August 1980 agreed an 8% increase for these workers. Employee representatives are now negotiating for a review but the company (at least at this stage) is offering nothing. Mr Sansome*said that the company enjoyed good industrial relations; most of the workers realised that Metro-Cammell had a falling work load and he expected more opposition (to the company's nil offer) from union officials than from the workers themselves. Nevertheless an overtime ban had been imposed. Mr Sansome justified the absence of any offer of an increase by saying that the workforce would just have to work harder.

(*Managing Director)

About 20% of Metro-Cammell's labour force is composed of "indirect" lower paid workers whose rates have been progressively falling behind. These workers were awarded a 15% increase on 17 August 1980 and "might" get a further 5% in the present round of negotiations

ii) Productivity

The firm tells us that over the past year productivity has increased by 8.75%. A year ago it took 1,000 men to produce 8 rail cars a week. At present it is taking between 900 and 910 men.

iii) Rise in manufacturing costs

State controlled Overheads	% OF M-C's TOTAL OVERHEADS	% INCREASE OVER LAST 12 MONTHS	AVERAGE
Gas, rates, electricity, water and National Insurance Contributions	25%	20%	20%
Fuel oil	5%	20%	

CODE 18-77

(FO 12/80)

Reference....................................

	% OF M-C's TOTAL OVERHEADS	% INCREASE OVER LAST 12 MONTHS	AVERAGE
Costs within M-C's Control			
Wages	50%	8%	8%
Costs of Materials / Pension costs	20%	8%	
	100%	11% (average)	

The firm was unable to say how M-C's increased costs compared with those of other similar engineering groups but referred to to CSO Digest of Statistics which, in Section 18.5, gave the index of average earnings as 11% (M-C 8%) and, in Section 18.11, gave index of materials costs as 17% (M-C 8%).

iv) The firms actions to control costs

Metro-Cammell point to the following as evidence of their successful efforts to control costs:-

a. following the 8% wage increase in August 1980 the company was not prepared to make any wage increase offer from August 1981;

b. the company had no costly occupation pension scheme of its own, but had "contracted in" to the State Pension Scheme;

c. M-C's major sub-contractors were GEC, BICC and Hawker Siddeley. Since work had started on the Hong Kong order, M-C had taken options for further equipment down the line (and each option had, according to the firm been more competitive). (When Mr Sansome 'phoned us on 21 August he told us that M-C took strenuous steps to hold down suppliers' prices.)

All in all this seems to be an encouraging picture and justifies our efforts to help the company to win business overseas.

J C S Priston

J C S PRISTON
MEE 3
ASH 538 X6008
24 AUGUST 1981

From The Minister of State

Foreign and Commonwealth Office

London SW1A 2AH

26 August 1981

MAP

Dear Leon

METRO-CAMMELL LTD: KOWLOON-CANTON RAILWAY (KCR)

I have seen a copy of Kenneth Baker's letter to you of 14 August requesting agreement to the provision of Cost Escalation Cover for the extension of Metro-Cammell's contract to supply rolling-stock to the KCR. I strongly support this request because there are wider issues at stake, not only because of the significance of the order for Metro-Cammell's future, but for other political and commercial reasons.

The original specifications for the modernisation of the KCR and the purchase of rolling-stock were drawn up by British consultants with the Metro-Cammell product in mind. It would do our export promotion work, in both Hong Kong and the Far East as a whole, considerable harm if a British firm failed to negotiate in a British Dependent Territory an extension of an order drawn up to British specifications, and the Hong Kong Government went to international tender. Success in the competitive Hong Kong market is highly beneficial in promoting British exports in the region. Conversely, failure there would have wider repercussions. For example, while it is true that economic readjustment has caused China to cut back her modernisation plans, it is expected that the Chinese will eventually require new rolling-stock for their own railways, particularly their part of the Kowloon to Canton line. If the whole KCR order is secured, Metro-Cammell would then be well placed for such orders.

It is also worth bearing in mind that a Transport Conference is being planned to be held in Hong Kong in February 1982. The aim is to promote the work of British consultants and exporters, using Hong Kong, which has bought much from our transport industry, as a showpiece. It could be serious if the KCR had, just prior to the conference, turned to our foreign competitors for the remaining rolling-stock it requires. I therefore hope you will agree to the provision of Cost Escalation Cover.

/I

I am copying this letter to members of EX Committee, to Norman Fowler and to Sir Robert Armstrong.

Yours ever

Nicholas

Nicholas Ridley

The Rt Hon Leon Brittan QC MP
Chief Secretary
HM Treasury
Parliament Street
LONDON
SW1P 3AG

oro

COMMERCIAL IN CONFIDENCE

DEPARTMENT OF INDUSTRY
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FROM THE
MINISTER OF STATE
FOR INDUSTRY AND
INFORMATION TECHNOLOGY
Kenneth Baker

Prime Minister

This is likely to be resolved without a meeting. MAP 17/viii

The Rt Hon Leon Brittan QC MP
Chief Secretary
HM Treasury
Treasury Buildings
Parliament Street
London
SW1

14 August 1981

Agreed - but what increase in pay did they award this year? MT

Dear Chief Secretary,

METRO-CAMMELL LTD: KOWLOON-CANTON RAILWAY

Metro-Cammell are currently working through a large contract to supply rolling stock for the Kowloon-Canton Railway, a contract which they were helped to obtain by support under the Cost Escalation Cover Scheme. The KCR authorities are sufficiently pleased with the first cars that have been supplied to want to extend the contract to include an additional 16 three-car sets.

Had KCR originally indicated that they might be interested in such an extension Metro-Cammell would certainly have pressed for such an option to be written into the contract and for it also to be covered by the Cost Escalation Cover Scheme. In fact, KCR only raised this possibility a few weeks ago. Metro-Cammell have asked ECGD for the same support for the extension to the contract, although they recognise that this might involve paying premium at the higher current rate of 2%. It is a cash contract, and therefore does not involve the interest make up costs that would normally be associated with an order of this scale.

Without CEC support Metro-Cammell could not undertake the contract extension without incurring significant losses. If they are obliged to turn down the opportunity of a negotiated contract, KCR will defer any additional purchases but will eventually go to international tender. ECGD calculate the cost of support at £1.7 million. Metro-Cammell would expect to negotiate a price of around £17.5 million.

I well understand the difficulties in making an exception to the normal arrangements under this Scheme. Nevertheless there are strong arguments for doing so. Metro-Cammell is the UK's only manufacturer of mass transit rolling stock and has good long term prospects both at home and abroad. In the 1990s London Transport will once more be ordering - Metro-Cammell estimate their annual requirement to be some £75 million at 1981 prices. Moreover there are a large number of cities around the world, particularly in the developing countries, who are considering setting up or extending mass transit systems. Many of these projects have been deferred through lack of money, but as transport problems grow in these expanding cities the pressures to establish such systems will eventually prove irresistible.

The problem is ensuring that Metro-Cammell survive to take advantage of these future opportunities. Their major customer, London Transport, does not propose to order any cars at all in the period 1983 to 1988. Although it is important in the context of public purchasing policy to have an even ordering programme, it appears that there is very little scope for London Transport to bring forward orders into this six-year gap.

Using their successful performance in both the UK and Hong Kong as show cases, Metro-Cammell are actively pursuing a number of overseas possibilities (such as Baghdad), but only two of these are sufficiently far advanced to provide work in the early years of the gap. The KCR extension is one and the new Island Line for the Hong Kong Mass Transit Railway is the other. Officials are currently examining a currency obstacle which if resolved will enable the company to negotiate a contract on the Island Line too, and I expect that this issue will be coming before Ministers shortly. The two contracts together would enable Metro-Cammell to survive with a slimmed down capacity during the early years of the gap and we are confident that other contracts at home and abroad can be found to carry them over the later years of the decade.

If Metro-Cammell were not able to accept these two negotiated contracts, we would have to face the very real possibility that Metro-Cammell would not survive the LT ordering gap, with the consequences that LT would probably turn overseas for their future requirements and that valuable export business in an expanding world market would be lost. This would be particularly galling when Metro-Cammell and the Government have put considerable effort into making Hong Kong an attractive show case for the company. Closure of Metro-Cammell would mean the loss of around 1500 jobs in the West Midlands, over 1000 of which are based on good long term prospects. A similar amount of work would be lost to Metro-Cammell's suppliers in the UK.

A decision on the KCR contract is required urgently. I hope you will be able to agree to the request for Cost Escalation Cover.

I am copying this letter to members of EX Committee, to Norman Fowler and to Sir Robert Armstrong.

Yours sincerely,

for KENNETH BAKER (Approved by the Minister and signed in his absence)