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Prime Minister

P.0957

Mr Lamont sent a message to say that he had deliberately pulled his punches in his E(NI) paper for fear of leaks. Their approach on closures would be much tougher

PRIME MINISTER

British Shipbuilders' Strategy and Finance
(E(NI)(83)2)

at the meeting
Ms 8/2

BACKGROUND

FLAG A

In E(NI)(83)2 the Secretary of State for Industry comments on the Corporate Plan of British Shipbuilders (BS) for 1982/83 to 1985/86, which is based on a strategy of reducing employment by around 7,000 from the present total of 65,000; of this reduction 1,200 would be in merchant shipbuilding, 2,000 in warshipbuilding and 1,100 in offshore work. He regards the Corporate Plan as over optimistic and unrealistic, particularly in respect of merchant shipbuilding, where he says that the long term prospects for reaching viability look doubtful. He proposes that the Government should neither accept nor reject BS's plan for merchant shipbuilding and that BS should be told that when the Government receives the next Corporate Plan (in May of this year, because of a change in the planning cycle), the Government will "expect to see options for a faster rundown of merchant shipbuilding".

2. The Secretary of State for Industry also proposes:

- that the Commission's approval should be sought to a further tranche of Intervention Fund assistance of £37 million for the year from July 1983 to July 1984, with the maximum rate of assistance reduced from 15 to 13 per cent of the price of ships;
- that it may be necessary to consider soft credit terms on a case by case basis but that after the receipt of the May 1983 Plan this should be made conditional on BS having put forward plans for recovering losses;

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- that the next Corporate Plan should contain options for reducing losses in the offshore division;
- that BS should in 1983/84 sell all their ship repair activities and accept that if Tyne Ship Repair Limited cannot be sold or its performance substantially improved it should be closed;
- that in 1983/84 BS should be set an EFL of £160 million and a loss target of £20 million; and should be told that their capital expenditure budget of £90 million is approved subject to being accommodated within their EFL.

MAIN ISSUES

3. There is unlikely to be any dissent from the view that the past performance of BS has been appalling and that its future prospects are dismal. As the conclusions of the Performance Review attached to E(NI)(83)2 state:

"In the face of a renewed recession in the world shipbuilding market there is little in BS's past performance to give grounds for optimism for the future."

FLAG B

In his minute to you of 2 February Mr Sparrow has drawn attention to the industrial objective of shifting resources towards areas of the economy capable of long term viability. In terms of this objective the case for running down as quiddly as possible the activities of BS, and particularly its merchant shipbuilding activities, is growing steadily stronger. There are however some difficult social and political implications to be faced.

4. The main issues for the Sub-Committee are therefore:
- i. whether the Secretary of State for Industry's proposed tactics for handling the merchant shipbuilding problem are acceptable;
 - ii. whether it is feasible and desirable to approach the European Commission on the lines proposed;

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iii. whether the proposed responses to BS on offshore and ship repair activities are acceptable;

iv. whether the proposals in respect of BS's EFL, loss target and capital expenditure are approved.

Tactics on merchant shipbuilding

5. It is convenient that, as it happens, BS will have to submit a new Corporate Plan as early as next May. The Secretary of State for Industry is taking advantage of this to place on BS the onus of producing a more realistic plan for the rundown of merchant shipbuilding. He thinks that it is neither necessary nor desirable to press for such a plan now rather than in a few months' time, and that it would also be difficult for the Government to set arbitrary parameters for the extent of the rundown. The Sub-Committee will want to satisfy itself that this is indeed the best way to proceed and that it is not merely an attempt to put off difficult but inevitable decisions.

Soft credit terms for new orders

6. If the Sub-Committee agrees that decisions about the rundown of merchant shipbuilding can be deferred until after submission of the new Corporate Plan in May, they may nevertheless want to limit the further uneconomic expansion of the activities. In paragraph 19 of his paper the Secretary of State for Industry is prepared to contemplate special soft credit terms pending receipt of the May 1983 Plan. Although any such proposals would have to be considered individually by Ministers, the Sub-Committee may feel that the general policy should be to rule out these special arrangements. It is clear enough, without waiting for the next Corporate Plan, that any orders taken on these terms are likely to inhibit the future rundown of merchant shipbuilding activities.

Intervention Fund assistance

7. The Secretary of State for Industry's proposal for a further tranche of £37 million for 1983-84 may be difficult to get past the Commission. Under the fifth Shipbuilding Directive, production assistance such as the Intervention Fund must be "degressive", temporary and linked to restructuring. Although both the total sum (£37 million) and the proposed new maximum 13 per cent rate of assistance per ship are degressive, the reduction is so slight that the



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Commission are likely to look especially hard at other aspects and will doubtless press for details of expected current and future losses. They are unlikely to approve more than a small proportion of new funds until the 1982-83 loss is known, and if it is as expected much higher than originally anticipated, this also will serve to encourage them in a restrictive attitude towards further Intervention Fund aid. In particular, they will probably try to insist on real cuts in capacity and not just employment. Careful thought will therefore need to be given to how and when the Commission should be approached: this is something which officials could be instructed to pursue further.

Offshore and ship repair activities

8. The Sub-Committee will probably wish to endorse the Secretary of State for Industry's proposed responses to BS about their offshore and ship repair activities. You may want to take this opportunity to reaffirm the existing policy that E(NI) must collectively approve any decision to take an offshore order at less than breakeven.

Financial proposals

9. We understand that the Chief Secretary, Treasury is being briefed to agree to the Secretary of State for Industry's financial proposals. In agreeing to the proposed EFL of £160 million and loss limit of £20 million, the Sub-Committee will want to stress again the need for a low wage settlement; the Chairman of BS has assured Ministers that he is aiming for less than 4 per cent, and this has been taken into account in the proposed EFL.

10. The Sub-Committee will want to examine carefully whether, bearing in mind the radical reappraisal which may follow the next Corporate Plan in May, the proposed capital expenditure programme of £90 million should be approved. A large part of the capital expenditure is for the Trident project and for other warship work. £20 million is however for the merchant shipbuilding division and of this perhaps £12 million is tied to improving facilities rather than investment in movable equipment, and might thus be wasted if the yards concerned were eventually to be closed. There might be a case for withholding approval for capital expenditure by BS in the merchant shipbuilding division of a non-movable nature, pending consideration of the next Corporate Plan in May.

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There is however the risk that this may precipitate rumours of yard closures; it may be argued/ ^{that} the sums involved (perhaps £1-2 million at any individual yard) are not sufficient to justify taking this risk.

HANDLING

11. The Secretary of State for Industry will want to introduce his memorandum. You will probably wish to give the Chief Secretary, Treasury the first opportunity to comment. Several other Ministers have an interest in BS's plans: the Secretary of State for Scotland is concerned with the fortunes of BS's Scottish yards; the Secretary of State for Northern Ireland with Harland and Wolff. The Secretary of State for Defence or his representative may wish to comment on BS's warshipbuilding activities.

CONCLUSIONS

12. You will want to reach conclusions on the following proposals in E(NI)(83)2:

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20.

- i. whether BS should be told that the next Corporate Plan in May should include options for a faster rundown of merchant shipbuilding (para 17 of the paper);
- ii. whether Ministers should be prepared for the time being to consider, on a case by case basis, special soft credit terms but that after the May 1983 Corporate Plan soft credit should be made conditional on BS having put forward potential plans for recovering losses (para 19 of the paper);
- iii. whether the Commission should be asked to agree to a further tranche of Intervention Fund assistance of £37 million for the year from July 1983, with the maximum rate of assistance reduced from 15 to 13 per cent of the price of the ships (para 18 of the paper), subject perhaps to further advice from officials on the method and timing of the approach;

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Loss



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iv. whether the proposals in respect of offshore and ship repair activities in paragraphs 20 and 21 of the paper are approved;

v. whether the financial proposals for 1983-84 are approved, ie:

- an EFL of £160 million
- a loss target of £20 million
- capital expenditure of £90 million (including about £20 million for the merchant shipbuilding division).

CONQUEROR

PLG

P L GREGSON

8 February 1983

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10 DOWNING STREET

Prime Minister

British Shipbuilders: E(N1) paper

Mr Lamont's office ~~was~~ telephoned
to explain that their E(N1)
paper pulled its punches on
closures - because of worries about
leaks; they will be producing a
much tougher approach orally
at E(N1)

MLS 2/2

nat Ind.
This
note to go
in E(N1) folder
for 9/2/83

BREAKDOWN OF TENDERS

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7/2

Korea (New ship)	£9.3 million
Harland+Wolff	Estimate 50 per cent above Korea's and no guaranteed delivery date
Japan (New ship)	£15 million
BS Sunderland (New ship)	£18 million £16 million
Netherlands	£19.5 million

4 February 1983

CEGG CABLE LAYING BARGE

British Shipbuilders (BS) tendered to two contractors: Fed Nav and London Marine. BS have told us that their price was £3 million although the CEGB have said that the contractor quoted to them a price of £16 million from BS. The precise reasons for this discrepancy are being explored.

The work would have been done at Sunderland Shipbuilders (the Deptford Yard) which employs about 1,000 men. This Yard runs out of steel work in May, and of outfitting work by the end of this year. If Sunderland had secured this offer, they would have kept the steel fabricators (600 men) fully employed until October. A further 600 outfitters would then be employed until March 1984. There is a gap of several millions between BS price and the Korean price. If Ministers wished to try to bridge this gap there could be three possible ways:

- a. increased intervention fund support - BS assumed only 10 per cent when making their bid, IF support at the maximum of 15 per cent would reduce the BS price by between £500,000 and £750,000;
- b. progress payments from the purchaser could be re
- c. BS could go beyond the credit normally available to UK buyers.

The second and third of these would have an adverse financial impact on BS which will in any event be under extreme financial pressure in the coming year.

Notes

1. Because the exact level of the BS bid is still under dispute, we cannot precisely quantify the gap between the Korean price and BSs.
2. If Department of Energy advice that this contract is firm, there is no scope for exploring the point made about how to bridge the gap.

4 February 1983