

*Not End
CGTV*

Foreign and Commonwealth Office

London SW1A 2AH

9 February 1983

From The Minister of State

Rt Hon Douglas Hurd CBE MP

Dear Patrick,

BRITISH SHIPBUILDERS STRATEGY AND FINANCE

I have seen a copy of your Memorandum E(NI)(83)2 about British Shipbuilders' strategy and finance. As I shall not be attending Wednesday's meeting I am setting out my views in this letter.

Your Memorandum already draws attention to the difficulties we shall face in securing Commission approval of these proposals but I should like to underline this point. In particular, the extent to which British Shipbuilders' actual losses have exceeded the £10 million loss target is likely to cause major problems and will need very careful handling. As you know, the Commission are under pressure from the Germans to take a tough line on loss financing and will want to be able to show that they are making progress towards its elimination. They will therefore find the inflated losses for 1982/83 and the higher loss target for 1983/84 most unwelcome. This is bound to affect their attitude towards our application for the next tranche of IF aid for 1983/84.

Against this background I think we must accept that the Commission will almost certainly hold out for capacity reductions in return for clearance of our aid proposals. I therefore agree with you that we should be pressing BS now to come up with specific restructuring proposals, for Community as well as public expenditure reasons. In the meantime I suggest that officials from the departments concerned, including the FCO and UKRep Brussels, should be asked to consider the timing and handling of our next approach to the Commission about the IF aid tranche for 1983/84.

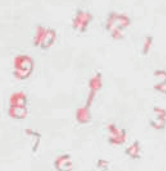
I am copying this letter to E(NI) colleagues and to Sir Robert Armstrong.

*Yours,
Douglas*

Rt Hon Patrick Jenkin MP
Department of Industry
Ashdown House
123 Victoria Street
LONDON SW1

West Ind
Shipbuilding
Pt 4

9 FEB 1983



CONFIDENTIAL

E(NI)(83) 2nd

9.2.83

Item 1.

A

CONFIDENTIAL

Nat. Ind

1. BRITISH SHIPBUILDERS

Previous Reference: E(NI)(82) 1st Meeting, Item 1

The Sub-Committee discussed a Memorandum by the Secretary of State for Industry on British Shipbuilders' strategy and finance (E(NI)(83) 2). They also had before them a letter of 9 February from the Minister for State, Foreign and Commonwealth Office (Mr Hurd) to the Secretary of State for Industry.

THE SECRETARY OF STATE FOR INDUSTRY said that British Shipbuilders' (BS) performance and prospects were profoundly unsatisfactory. The markets for merchant shipbuilding, offshore and shiprepair work had turned into severe recession. The Corporation now expected to lose £57 million (after crediting assistance from the Shipbuilding Intervention Fund) in 1982-83 against its target of £10 million; substantial losses were expected in all other operating divisions, except for warship building. Against this background, and in the light of BS's past losses and over optimistic planning, the strategy set out in the Corporation's corporate plan for 1982-83 to 1985-86 was unrealistic. The plan envisaged some reductions in employment throughout the Corporation but did not involve the closure of any of the yards engaged in the main loss making activity, merchant shipbuilding.

The Government could not accept BS's corporate plan. The question was therefore whether the Government should reject the plan outright and insist on the Corporation's producing a detailed plan now for the further rundown of merchant shipbuilding employment to perhaps 15,000 men, or further; or should put pressure on BS to include a properly worked out contraction programme, based on realistic assumptions about the prospects for the Corporation's yards, as part of its next corporate plan, which was due in May 1983. In his view the latter course would be better. BS's yards would not begin to run out of work until the middle of 1983. If preparations were set in hand now to close yards, they would become public knowledge and allow time for a protracted and damaging campaign of resistance to develop.

CONFIDENTIAL

The gravity of the Corporation's financial position and prospects was not widely appreciated. By May it would be much clearer that BS's plan had been produced on unrealistic assumptions, and much easier to justify a decision to close yards. The Minister of State, Department of Industry had already indicated to Sir Robert Atkinson, the Chairman of BS, that the Government would expect the May corporate plan to include options for reducing the underlying annual rate of loss on merchant shipbuilding (after crediting assistance from the Intervention Fund) to £55 million, £45 million or £40 million. He accordingly proposed that the Government should neither accept nor reject BS's plans for merchant shipbuilding but should tell the Corporation that in the next plan the Government would expect to see options for a faster rundown of merchant shipbuilding. The Chairman designate of British Shipbuilders, Mr Graham Day, who would effectively take control of the Corporation in September, could be expected to bring a new and more vigorous approach to BS's problems.

BS's corporate plan envisaged that both Cammell Laird and Scott Lithgow would remain engaged on offshore work. This was a risky strategy given the poor market prospects in this area. He proposed that it should be made clear to BS that their next corporate plan should include options for reducing losses in this division. The market situation was similarly bleak for shiprepair. The Government should aim to get BS to dispose of all its remaining shiprepair activities during 1983-84: the provisions of the Shipbuilding Bill at present before Parliament would assist in achieving this objective. There was excess engine building capacity both at BS and Harland and Wolff: he would be bringing forward proposals to his colleagues to deal with this, in the light of the report by consultants which the Sub-Committee had agreed should be commissioned when they had last discussed British Shipbuilders.

He proposed that in 1983-84 BS's external financing limit (EFL) should be £160 million and their loss target £20 million; that the Government should approve their capital expenditure budget of £90 million (subject to this being accommodated within the EFL) and that the Government should seek the approval of the European Commission for a further tranche of assistance from the Shipbuilding Intervention Fund of £37 million from July 1983, with the maximum rate of assistance reduced from 15 per cent to 13 per cent.

BS had begun to request topping up of normal credit terms for shipbuilding orders, on a case by case basis. He proposed not to make soft credit available before receipt of the next corporate plan; and thereafter to make it conditional on the Corporation's having put forward potential plans for recovering losses.

The following were the main points made in discussion -

a. The true cost of assistance to BS greatly exceeded payments from the Shipbuilding Intervention Fund and under the Shipbuilding Redundancy Payments Scheme. If unremunerated public dividend capital and subsidies paid to ship owners who placed orders with BS were taken into account, the total subsidy per BS employee probably worked out at around £7000 per annum. This was significantly more than the subsidy per employee in other loss making public sector enterprises, including Harland and Wolff.

b. It was argued, on the one hand, that there was a strong case for requiring BS now to prepare a detailed plan for a substantial reduction in manpower. There was a risk that BS would press successfully for new orders over the next few months. Any such orders, particularly if allocated to yards with the worst chances of viability, would add to the difficulty of rationalising BS and commit the Government to further support costs during the later years of the public expenditure planning period. If the Government was prepared to contemplate taking radical action to reduce losses at BS, it might as well do so now as in or soon after May.

c. On the other hand it was unlikely that, over the next few months, BS would be anything like as successful in attracting orders as their plan assumed. By May it would therefore be clear that the Corporation's planning assumptions had been too optimistic. It would be much easier to defend yard closures and redundancies in those circumstances, and against the background of the detailed, realistic

plan which the Secretary of State for Industry proposed to require from BS, than in present circumstances. By May BS would also have gone considerably further than at present towards completing ships at present in its yards, thus reducing the opportunities for the workforce to disrupt work in progress and frustrate closure plans. The pressure on BS to reduce losses should help to ensure that any new orders were placed in the most suitable yards.

d. BS's plan was widely optimistic about the prospects for offshore orders; the Corporation would be doing very well if it obtained as many orders as the "lower case" in its corporate plan assumed. In particular there seemed no chance that any oil company would place an order with Scott Lithgow, which had a poor reputation.

e. If a major yard was to be closed, it seemed clear that Scott Lithgow would be the most likely candidate. If two major yards were closed, Govan, also on the Clyde, might well be the other. Closure of one or both of these yards would add significantly to unemployment in West Central Scotland; but there was unlikely to be much sympathy for Scotland for workers in these yards, who, despite large scale Government support for a number of years, had not made the necessary efforts to improve the yards' performance.

f. BS probably had excess capacity for warship building. For example work on replacing frigates lost in the Falklands campaign was being spread among more yards than would have been desirable. Decisions about the placing of the orders would have to be consistent with the public statements which had been made.

g. In order to limit any further uneconomic expansion of BS's activities, it would be important to try and avoid giving soft credit terms for ship owners ordering from BS. The Secretary of State for Industry's intention not to consider any soft credit assistance before the receipt of BS's next corporate plan would assist in this respect.

h. BS's capital expenditure plans included about £20 million for merchant shipbuilding, of which perhaps £12 million involved improving facilities rather than investing in movable equipment. It would be unwise to undertake new investment, particularly in immovable facilities in yards whose future was in serious doubt. On the other hand it would be difficult to put a stop to all investment in a yard: the workforce could take such a decision as an indication that the yard was going to close.

i. It was likely to be difficult to negotiate the proposed 1983-84 tranche of Intervention Fund assistance with the European Commission. The Commission were under pressure from some Member States to ensure that any further loss financing was accompanied by measures to rationalise shipbuilding. The Commission were therefore likely to seek capacity reductions in return for agreeing to the Government's proposals for Intervention Fund assistance.

THE PRIME MINISTER, summing up the discussion, said that the Sub-Committee agreed that steps must be taken to reduce losses by British Shipbuilders, especially on merchant shipbuilding. The Corporation needed to consider whether and how it could develop into a viable shipbuilding industry. In the short term there was unlikely to be any way of stemming losses other than yard closures and redundancies going beyond those in BS's corporate plan: the Sub-Committee hoped that BS's Chairman-designate, Mr Day, would be prepared to take difficult decisions of this kind.

As had been pointed out in discussion, there was a case for requiring BS now to prepare a detailed plan for a further rundown of merchant shipbuilding. On balance, however, the Sub-Committee concluded that, for the reasons advanced by the Secretary of State for Industry and in discussion, the Government should proceed broadly on the lines proposed in E(NI)(83) 2, neither accepting nor rejecting BS's corporate plan, but indicating that the next plan needed to take a much more realistic approach to the Corporation's problems and prospects. The Secretary of State for Industry should make clear to BS that the plan must contain options, based on realistic assumptions about levels of orders, for reducing the underlying annual rate of loss on merchant shipbuilding to £55, £45 and £40 million (after crediting Intervention

Fund assistance); it would need to include plans for the rundown of employment and the closure of yards. Meanwhile, the Government should do its best to ensure that any new orders were not placed in yards which would probably have to be closed in the near future.

The Sub-Committee approved the Secretary of State for Industry's proposals on BS's offshore work, shiprepair and engineering; and his proposals for BS's 1983-84 EFL and loss limit. They agreed that capital expenditure of up to £90 million in 1983-84 could be authorised; but the Secretary of State for Industry should consider with especial care any proposal for substantial investment in a yard whose future was in doubt: the Government should not permit wasteful capital expenditure.

It would be necessary to give careful thought to the handling of the Government's approach to the European Commission about the proposed tranche of Intervention Fund assistance, as the Minister of State, Foreign and Commonwealth Office, had argued in his letter of 9 February; but it was important that Commission approval of a further tranche of Intervention Fund assistance, on the lines proposed by the Secretary of State for Industry, should be obtained.

The Sub-Committee -

1. Invited the Secretary of State for Industry to indicate to British Shipbuilders, taking account of the points made in discussion and in the Prime Minister's summing up, that the Corporation's next corporate plan must take a realistic approach to its problems and prospects, and in particular contain options, based on realistic assumptions about levels of orders, for reducing the annual rate of loss on merchant shipbuilding, and on offshore work.
2. Agreed that the Government should aim to get BS to dispose of all its remaining shiprepair activities in 1983-84.
3. Noted that the Secretary of State for Industry would bring forward proposals to deal with the problem of over capacity in engine building at both British Shipbuilders and Harland and Wolff.
4. Agreed that in 1983-84 British Shipbuilding's external financing limit should respectively be £160 million and £20 million.

5. Subject to the points made by the Prime Minister in her summing up of their discussion, agreed that the Secretary of State for Industry should authorise BS to undertake investment of up to £90 million in 1983-84.

6. Agreed that the Government should seek the agreement of the European Commission to a further tranche of assistance from the Shipbuilding Intervention Fund for the year from July 1983 totalling £37 million for the shipbuilding industry as a whole, with the maximum rate of assistance reduced from 15 per cent to 13 per cent of the price of ships; and invited the Secretary of State for Industry to arrange for his officials to consider, in consultation with those of the Foreign and Commonwealth Office and other interested Departments, the timing and handling of the Government's approach to the European Commission.