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Secretary of State for Trade and Industry

13 June 1985

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Andrew Turnbull Esq
Private Secretary to the
Prime Minister
10 Downing Street
London SW1

Dear Andrew,

BL/HONDA

Thank you for your letter of 10 June.

On the instructions of my Secretary of State, the final terms for the announcement of the Government's response to the BL Corporate Plan have now been agreed with the company. As you know, it is proposed that the Government response to the Plan, and the announcement by BL/Honda of their further collaborative proposals, should be made on Monday 17 June. My Secretary of State believes that an early announcement is necessary in order to limit any further damage which might be caused to BL by continued unhelpful press speculation about Government attitudes to the company.

Your letter records that the Prime Minister wanted reassurance on a number of points. First, that the agreement between BL and Honda should not close off the possibility at some future date of an engine supply deal between Honda and BL. Second, that Honda should be pressured to go ahead with an investment in an engine facility at Swindon. Third, that the BL Board should agree arrangements for the control of BL borrowings in line with the agreement reached recently by Ministers.

On the first point, my Secretary of State has accepted that, given the tight timetable to which everyone is now working, it would not be possible to engineer amendments to the proposed Memorandum of Understanding between BL and Honda (which would need to be approved by the Honda Board), or an equivalent side-letter, without risking further misunderstandings and uncertainty in the minds of the Japanese. However, BL has agreed that it should put Honda on notice - in Mr Musgrove's reply to Mr Kume's recent letter on Honda's engine policy - that ARG is

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willing to discuss engine collaboration/supply in relation to any future models. My Secretary of State believes this letter makes it plain that ARG does not stand on the Memorandum of Understanding as stating a policy of refusal to purchase Honda engines. It is thus open to Honda to propose such a deal. The text of the proposed letter is attached.

Second, my Secretary of State believes that the most appropriate way of persuading Honda to invest in an engine assembly facility in the UK is to set demanding requirements for the local content of the vehicles to be produced in the UK either collaboratively or on a sub-contract basis. There would be difficulty in regarding vehicles as non-British solely because the engine was imported if, nonetheless, they achieved levels of local content previously regarded as high enough to be accepted as British. This would be clear discrimination against Honda compared with the treatment of Nissan and GM/Bedford (to build Isuzu vans) who have been set rigorous (80%) local content targets but who are free to decide how these are achieved. Moreover, internationally we could not adopt a position whereby we doubted whether vehicles of 60:80% local content were truly of "European" origin. Indeed we have in the past resisted French/Italian efforts to establish a "key components" policy under which vehicles with a non-EEC engine would fail to qualify as "European".

Nevertheless, in practice, the 80% local content regime exerts a considerable pressure on companies to carry out engine assembly or manufacture locally. Nissan in Phase 2 have plans to carry out engine assembly at their Washington Plant in order to meet their target. And, in the case of the Rover 200 series, BL have achieved only 70% British content in the Honda engined version (the 213) but 83% in the BL engined 216 version.

Can't be changed?
We believe Honda will also wish to establish an engine facility at Swindon and that their insistence on a "possible" engine investment simply reflects boardroom sensitivities and perhaps confusion over HMG's inquiry about the supply of a small engine to BL.

To achieve the Prime Minister's objective, my Secretary of State therefore intends that Mr Okamura should be advised at his meeting with DTI on Friday 14 June: -

- that HMG will wish to negotiate a formal MOU with Honda/BL covering the local content requirements to be set for all vehicles covered by their co-operation with ARG including the new collaborative vehicle and the sub-contract cars;



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- that, after a transitional period, 80% local content would be the norm. Anything less would be unacceptable to HMG;
- that proceeding with an engine assembly facility would obviously be one way of making a significant contribution to local content and HMG would welcome it if Honda were to proceed with such an investment at Swindon.

On the question of borrowing limits, my Secretary of State expects to reach an agreement with the company which would prescribe a formula to which he hopes the Chancellor will agree by which the impact of Unipart privatisation would adjust the EFL limit in line with the decision already taken by Ministers collectively. That formula would be applicable to other disposals, whether of profitable or loss making operations.

My Secretary of State therefore believes that the outstanding questions raised by the Prime Minister have in substance been met and that the way is now clear for an agreed announcement which will put an end to the uncertainties which have affected the company's public image over recent months.

I am copying this letter with enclosures to Rachel Lomax (HM Treasury), Leigh Lewis (Office of the Minister without Portfolio) and Richard Hatfield (Cabinet Office).

Yours ever,

John Stagg

J F MOGG
Private Secretary