



JU282

PRIME MINISTER

CONFIDENTIAL

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NO

First we must make
the fundamental how many yards we want to
take this decision
at the beginning of our
2nd term

SHIPBUILDING - EC NOTIFICATION OF UK SHIPBUILDING AID

1 I had originally envisaged putting a paper to E(NI) this month on new strategy for BS following its change of chairmanship. I now find that I need a little longer to work out with Mr Day a credible range of options, and it will thus be towards the end of January before an E(NI) discussion can usefully take place. However, I am anxious not to delay notification to the EC Commission of a new support regime since initial soundings have indicated that the negotiation to secure its agreement will be prolonged. You will recall our decision last July to take soundings about our intention to increase shipbuilding support levels.

? Please
 just re-use
 terms

2 An early notification would bring forward the start of substantive negotiations and strengthen our case for a further interim extension of the Intervention Fund (IF) beyond end-January 1984; Commission agreement to our proposals for enhanced aid is unlikely to be secured before then. Moreover early notification would facilitate moves to bring to bear pressure by member states collectively for a temporary relaxation of the rule against aid increases. I hope therefore that we can notify as soon as possible.

should we be
 encouraging
 other countries
 to raise their
 bids?



... 3 I envisage notifying in terms of the attached draft, which closely resembles a draft agreed inter-departmentally among officials. If you are content with its broad thrust, officials can pursue further any additional amendments that might be needed.

?

On what basis?

4 On the substance of the proposals, I envisage opening negotiations on the basis of an intensity of up to 35% - Mr Day's requested figure. The Commission is unlikely to agree to such an increase, but this bid may help to set a benchmark for the very exceptional cases in the core yards. On the amount of support ("volume") our bid needs to be compatible with up to 35% intensity.

5 At present Mr Day sees the need for an IF volume of the order of £35m for 84/5 and £41m for 85/6. This compares with £40m in 1982/3 and £45m in 1981/2, at a lower intensity. I propose to open the negotiations with a bid of £100m for two years, partly as a negotiating tactic and partly to accommodate the needs of the private sector. For Harland and Wolff the bid would be £20m for the two years. Experience shows that it is essential to build in a substantial negotiating margin in our initial bid.

Naturally we would not be committed to spend up to the figure finally approved by the EC. Moreover by the time negotiations reached an advanced stage we should have a firm idea of the aid levels that would be compatible with the future we envisage for BS.

Why should we bid up as a negotiating tactic. We would be bidding down.

The fact that the IF was approved would lead to spending up to it.

Whatever happened to Norman Lamont's assertion that

the public interest is not to spend food money after the fact.



8 To persuade the Commission, we shall need to exert considerable pressure on them bilaterally, probably at Ministerial as well as official level. And as I have already mentioned, we shall need also to mount collective pressure on the Commission with like-minded member states, a process which has already begun. Even so the Commission might well insist on clearance by the Council of any significant enhancement of the UK regime and on obtaining beforehand a Council steer on the Fifth Directive's future.

7 Thus the timing of a Commission decision on our proposed regime is not in our hands. However hard we press it could be quite a way into 1984 before the issue is resolved. In the meantime we shall have to rely, as now, on the use of IF at the present level supplemented by various forms of soft credit on a case-by-case basis.

8 I should be grateful to know whether you and other E(NI) colleagues are content that I should proceed on this basis. No

9 I am copying this minute to E(NI) colleagues, Geoffrey Howe, Jim Prior and Sir Robert Armstrong.

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22 December 1983

DRAFT LETTER

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BELGIUM

UK SHIPBUILDING AID REGIME

1. My authorities have asked me to notify the Commission of the regime for shipbuilding they propose to introduce.

2. The UK industry has been hit particularly hard by the sharp deterioration of the world market and the poor order situation. The UK industry now faces a crisis and the risk of disorderly collapse with serious social consequences. As an illustration of the scarcity of orders, British Shipbuilders' order book at end October 1983 was 346,000 cgrt compared to 483,000 cgrt at end-1982. Of the present (end-October) order book only 71,000 cgrt represents orders on which work has not begun compared to 153,000 cgrt at end-1982. Harland and Wolff's order book at the end of August amounted to 64,266 cgrt compared to 92,532 cgrt at the end of 1982. Work has already commenced on all of these orders.

3. In view of the market crisis and the industry's uncertain prospects the Government is calling for major efforts to improve the industry's competitiveness. Much has already been done since our last aid notification in June this year. In British Shipbuilders as a whole 3,967 (including 2,677, 12% of merchant employment) redundancies were called for in July 1983 and a further 2,098 (including 430, 2% of merchant employment) in October 1983; in addition some 4,350 jobs (including 1,560, 7% of merchant employment) are at risk between October 1983 and March 1984. If all these prospective job reductions take place, between July 1983 and March 1984 4,677 merchant jobs (ie 21% of the merchant division employment at June 1983) will have been lost. The new Chairman (Mr Graham Day) has been given a tough remit - to do whatever is necessary to bring about a radical improvement in efficiency and a return to profitability.

*So has
very other
country. Our
share of
new orders
has gone down*

?

The Government and Mr Day are currently considering the steps necessary to achieve these aims. The details of the new strategy will be progressively emerging in the next few weeks, within the agreed objective of moving rapidly into a core of cost-effective yards with a substantial contraction in capacity.

If this is not done quickly there is a serious risk that some of these good yards may be lost as well as the less productive yards which it is planned to close. The success of the strategy, however, will turn crucially on the provision of the regime of support set out in this letter.

4. [The Government has already approved a new strategy for Harland and Wolff prepared by its new Chairman.] This is aimed chiefly at a significant improvement in efficiency through cost-cutting and more effective use of management and technology. Significant capacity reduction is difficult since building takes place in a single dock, but between March and July 1983 manning was reduced by a further 750. The main objective of Harland and Wolff's new strategy is for the company to increase cost-effectiveness. Building costs are to be reduced by a productivity improvement programme - mainly the application of new technology and improved manning and control - and a cut in material costs. Harland and Wolff will also be switching the emphasis of its marketing away from large unsophisticated tonnage to more complex vessels where Far East competition should be less intense.

Leaving how many? There are no spare yards in the works.

5. The industry's performance however cannot be transformed overnight - time is needed for the industry to make these necessary changes leading to a definitive

solution of the problems confronting it. The UK Government also considers it essential to maintain its proper contribution to a healthy and competitive ship-building industry within the Community. To this end and to assist the industry to obtain new orders, additional aid will be needed for the next two years by which time the market should begin to pick up.

We have been trying 2 1/2 years, we were writing this and it tells them.

- But we may not get the orders.

may eventually
have to close
work
on
strike
or
lock
out
order.

6. A disorderly collapse would have grave and disruptive social consequences - regions where unemployment is already severe, ie Northern Ireland, the Clyde and the North East would be particularly hard hit; despite efforts by the Government via its Regional policies to renew the infrastructure and to provide a broader based, more stable pattern of alternative employment in these areas where shipbuilding and other traditional, heavy industries are in serious decline. The problem is further complicated by manpower reductions that will be taking place in some of BS' other activities.

7. The UK Government continues to support the Community principle of degressivity, as our shipbuilding policy for restructuring and aid has amply demonstrated over the last four years. But with the continuation of the crisis and its serious present consequences for the UK shipbuilding industry we believe that to be realistic our and Community policy must be flexible enough to reflect the conditions of the industry and the state of the market. It is not realistic to insist on continuing degressivity at a time when demand and prices have plummeted and Far Eastern yards are quoting prices which are sometimes below even their costs according to the Commission's own annual report on the industry. As the Commission knows, this view is shared by most other member states. Insistence on degressivity in present circumstances would mean virtually no new orders; a precipitate and disorderly capacity contraction of the Community's industry; abandoning the field to the Japanese and other Far Eastern countries and the EC industry's relegation to the status of a marginal producer. This outcome would conflict with UK and Community policy and would be unacceptable on social and political grounds.

8. With this said however the UK Government fully intends to ensure that the quantum of shipbuilding aid in the UK should resume as soon as possible the downward trend it has followed in recent years.

Competition within the Community

9. The UK is mindful of the need to ensure that when yards in different member states are pursuing the same order prospect competition among them should not be distorted by inequitable differential in available aids. The reality of the present situation however is that Far Eastern suppliers dominate the market and that in the overwhelming majority of cases they, rather than other EC yards, constitute the competition Community yards have to overcome.

- And they will

continue to do so.

Industrial policy implications

10. The new regime does not imply an intention to sustain the industry at a particular size regardless of cost. It is fundamental to the UK Government's general approach that the size of any industry must be dictated primarily by its ability to compete in the open market without Government aids. This applies to shipbuilding as it does to any other industry. The Government is also anxious to contain public expenditure and therefore to reduce the burden of shipbuilding aids on the Exchequer. However the pursuit of these objectives must be tempered by the need to avert a precipitate worsening of unemployment, particularly in regions where it is already a serious problem.

*but never
to particular
cases*

11. The UK can well understand that the Commission might be concerned about the possibility that the provision of additional aid would discourage necessary restructuring and adjustment to market conditions; but, as already indicated, our plans are for continuing major restructuring with the aim of achieving viability. It is also noteworthy that, far from having been insulated from market forces, the UK industry has contracted more than that of any other Member State: 54% between 1975 and end 1982 (see Table 1).

*its labour product
are worse than that of other
member states.*

Structural adjustment

12. In 1979 British Shipbuilders embarked on a major programme of restructuring which, inter-alia, resulted in the manpower contraction referred to in Paragraph 11. above and the closure of a total of 9 yards and of 36 out of 66 merchant berths. In general terms the very considerable fall in capacity that this represents is reflected in the fact that BS yards before nationalisation in 1977 were producing an average 623,000 cgrt annually, whereas BS' estimated current capacity is around 350,000 cgrt, slightly above the present order-book level of 344,000 cgrt.

13. By the end of that period losses had reduced considerably, and British

Shipbuilders were able to secure a reasonable volume of orders despite a progressive reduction in the amount and intensity of the Intervention Fund (Table 2). At that point, with a reasonably buoyant world demand, the situation appeared to call for a period of stabilisation during which the Corporation would be able to consolidate the gains already achieved and prepare for further improvements in competitiveness.

14. However, as conditions began to worsen, once again BS resumed their restructuring measures, reducing their merchant manpower by a further 2730 (13.7%) to 17170 by end-April 1983. Such restructuring unavoidably places an extra financial burden on the Corporation since during its course it has to bear the costs of under-utilisation of production facilities, the costs of eventual closure or dismantling of facilities, together with certain workforce redundancy costs under the Employment Protection (Consolidation) Act 1978.

15. In addition to structural adjustment in shipbuilding itself, BS have taken the firm decision to dispose of such of their shiprepair capacity as is saleable and to terminate the remainder.

16. So far as Harland and Wolff is concerned, as explained above, major reductions in plant capacity are not feasible. The company has however been implementing a programme designed to reduce other facilities (eg steel preparation and outfit shops) in line with actual and prospective utilisation. New merchant-building employment has reduced from 5,370 in 1982 to the present level of 4,200 (a reduction of 22%) and overheads have been significantly reduced *inter alia* by a 35% contraction in the size of the site.

Still too many for the possible rewards.

Form of additional aid

17. As it presents itself to the industry the problem is essentially one of price. Far Eastern yards in general determine the world price, owing to their dominant share of the market. As the Commission knows, in the last few months Far Eastern prices from Japan and Korea have dropped sharply. Our industry tells us that cost/price gaps of 35% and above are not uncommon.

12. 10/15

18. In these circumstances the current Intervention Fund intensity - 15% plus 2% Shipbuilders Relief (18% plus 2% Shipbuilders Relief for H & W vessels of 100,000 dwt and over) - is quite inadequate, given that its purpose is essen-

tially to help meet Far Eastern competition. If the UK industry is to be able to secure a reasonable amount of work in present circumstances, new measures are urgently needed to help it bridge the large cost/price gap that has emerged in recent months. To meet the needs of the situation an increase of the IF intensity of up to 35% is required. Because of the nature of the problem facing the industry and the need for a solution that would have immediate effect, the UK believes that only direct aid would be effective. Moreover direct support has the advantages for the UK Government of being transparent and easily controlled. Thus less direct and slower acting measures designed to assist modernisation and

restructuring would not be appropriate in the particular circumstances, though they may have a place in the longer term.

19. In consequence, the amount of Intervention Fund also needs to be increased.

For July 1982/1983 it was £40m for BS and the private sector and £10m for H & W: we envisage a figure of /£100m/ for BS and the private sector and £20m for H & W to cover the next two years.

As a Community Study we are in a
sharp position to keep pressure to bear on
these countries re their shipbuilding price policies

20. As regards the volume of Intervention Fund support it is relevant to note that, taking account of UK domestic inflation since 1977/78 when the Intervention Fund started, the volume of IF shows a substantially steeper decline than is apparent from the actual amounts at current prices. The figures are given in Table 2.

Features of British Shipbuilders' new strategy

21. The programme of capacity adjustment referred to above will underpin the new strategy whose main objective is to move rapidly to a defensible core of cost-effective yards. Based upon a fundamental reassessment of the nature of the shipbuilding market and of those particular sectors in which BS production should best concentrate, BS plans to rationalise its physical production facilities as well as its manpower and engineering resources. This rationalisation will entail the elimination of duplicated facilities, and the identification of and concentration of work in the minimum number of most productive berths. These production berths will be served by the optimum number of similarly rationalised manufacturing, processing and assembly shops.

Why has it not done so far?

22. These plans are to be based on a fundamental re-assessment of the nature of the shipbuilding market and of the particular sectors of the market on which the Corporation should focus. Essentially this means concentrating on the types of vessels on which Far Eastern competition is least severe. This approach is, of course, entirely in line with that advocated in the Commission's recent Paper on a policy for the Community's shipbuilding industries.

23. Within the core yards major productivity improvements are scheduled; these include the continued development and implementation of a common core technology. Capital investment will be directed towards further improvements in performance and productivity, including a substantial investment in Computer-Aided Design and Manufacture.

which

Let more capital investment?

24. In depth research is now being put in hand to ensure that the new strategy and its implementation reflects a realistic assessment of the market for the Corporation's products. The results of the market research currently under way will also assist the Corporation in achieving its targetted sales in to be identified product areas related to specific facilities.

*Andrew - this is just windy
It is the sort of thing
that could have been written
during the heyday of Boney.*

Conclusion

what plan?

25. The UK Government believes that nothing short of this planned regime of aid during restructuring will permit the proper handling of the serious and immediate problems facing the UK shipbuilding industry. The UK Government remains firmly committed to the principle of degressivity of shipbuilding aids, but believes that the present desperate situation of the shipbuilding market compels a moratorium on this policy within the European Community. The Commission will no doubt recall that at the 18 October 1983 Multilateral meeting on shipbuilding the majority of Member States supported the UK proposal for a temporary (2 year) suspension of the Fifth Directive requirement that aids must be degressive. The DG IV representative at that meeting indicated that the Commission would take note of Member States opinions and would urgently consider the matter further.

26. For the reasons indicated above the UK Government is anxious to institute the new aid regime at the earliest possible time, and desirably from 1 February 1984, immediately following the expiry of the present interim IF arrangement. In this connection the Government stands ready promptly to supply the Commission with any further information they might require.

The Govt is not in a position to do so. The kind of plan Govt has not yet had a been able to get the Disposal plan, nor a paper to K on the essential decisions that have to be taken.

and

TABLE 1.

EMPLOYMENT IN NEW MERCHANT SHIPBUILDING IN THE COMMUNITY (End of year)							Percentage Contractio
	1975	1978	1979	1980	1981	1982	1975-1982
Belgium	7467	6614	6258	6523	6119	5.031	32.6
Denmark	16630	12000	9900	11400	11350	11.8 00	29.0
France	32500	25300	23000	22200	22200	22.000	32.3
Germany	46839	31113	27369	24784	26521	27.600	41.1
Greece	3393	3.696	-
Ireland	869	840	750	750	762	882	-
Italy	25000	20000	19000	18000	16.500	13.750	45
Netherlands	22662	17540	14540	13100	13100	13.100	42.2
United Kingdom	54550	41050	31200	24800	25345	25.000	54.1
Sub-total	206517	154457	132017	121551	124897	119163	
less Greece							
Total					125290**)	127850	

Source: EC Commission Report on Shipbuilding in the Community at 1/1/83.

TABLE 2INTERVENTION FUND TRANCHES

	1977/8	1978/9	1979/80	1980/1	1981/2	1982/3
Intensity (%) ⁽¹⁾	30	30	25	25	20	17 *
Volume at Current Prices (£m) ⁽³⁾	65	85	65	55	45	40
Volume at Constant (1977/8) Prices ⁽²⁾ (£m)	65	77.2	50.3	37.3	27.6	23.2

NOTES

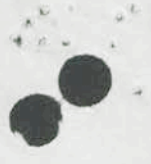
* 20% for H & W ships over 100,000 dwt

(1) Including Shipbuilders Relief at 2%

(2) Volume figures adjusted to take account of the increases in the general level of prices, taking the average 1977/8 price level as a base.

(3) GB yards only. Volume for H & W is :
15 (1977-79) 25 ('79-'81) 10 ('81-'82) 10 ('82-'83).

Source: DTI



1983

