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P.01516

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PRIME MINISTER

The Royal Dockyards - Open Government Document

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E(A)(85)15

BACKGROUND

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C —

You chaired a meeting on 30 January which considered options for the future management for the two remaining Royal Dockyards - Devonport and Rosyth, on the basis of the Defence Secretary's earlier paper on the future of the Royal Dockyards (E(A)(85)1). This brief should be read in conjunction with my brief P.01477 for that earlier discussion. Mr Heseltine then argued against a trading fund within the Civil Service, and against full-scale privatisation. Instead he argued for 'contractorisation' - now renamed 'commercial management' - as the arrangement which offered the best prospect of improving efficiency, introducing competition, and safeguarding strategic interests.

2. The Sub-Committee accepted the need for changes, but were not satisfied that the introduction of commercial management could be publicly demonstrated to be clearly superior either to full privatisation or to a determined effort to improve efficiency while retaining Government ownership and control. They recognised that publishing an ill-conceived plan would expose the Government to criticism, and unsettle the workforce. Mr Heseltine was invited to work up a detailed document setting out his proposal and also giving serious consideration to the option of full privatisation.

3. The main features of the commercial management proposal are:

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- (i) open competition for the management of each dockyard for a fixed term of about four years. Dockyard and equipment to remain in public ownership; workforce transferred to a private sector company operated by company holding the management contract for the time being;
- (ii) the Royal Dockyards to undertake 'core' naval refitting work corresponding to 70-80 per cent of total naval requirements, at prices set as far as possible by the initial competitive tender;
- (iii) dockyard contractors and private shiprepairers to compete for 'non-core' Ministry of Defence (MOD) work, with the dockyards also permitted to compete for a certain amount of private sector shiprepair work;
- (iv) 3-4,000 redundancies, mainly at Devonport, costing £30-40 million;
- (v) other costs of £5-10 million for capital refurbishment and other preparatory work and £15 million to buy out working practices;
- (vi) continuing costs of about £35 million a year in respect of the contractors' profits and the costs of the customer organisation; against these, 30 per cent efficiency improvement would save £65 million a year.

MAIN ISSUES

4. The main issues are:

- (i) Does the proposed Open Government Document demonstrate that the introduction of commercial management is the best way of securing greater efficiency in the dockyards?



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(ii) Are the arguments against full privatisation accepted?

The Draft Open Government Document (OGD)


5. The OGD sets as the Government's aim securing better value for money from the dockyards. It identifies the need for a new structure which will provide a clearer relationship between the customer and contractor, with greater awareness of costs and more freedom for management to secure efficiency. It reflects the Government's conviction that the full benefits of competition and economic efficiency can only be achieved where activities are carried out in the private sector. The various courses of action are tested against these broad criteria:

(a) Trading Fund

The document rejects this approach on the grounds that customer would remain tied to the supplier, and therefore not in a strong position to press for efficiency savings, while the supplier would be precluded by the continuing status of dockyard employees as civil servants, and the continuing application of civil service manpower and expenditure controls, from exercising the managerial freedom required to secure the efficiency savings.

(b) 100 per cent Government-owned company, as a prelude to a flotation.

The arguments against this approach (which would remove any civil service constraints, in the same way as has been done in the case of the Royal Ordnance Factories) are that it would not overcome the problem of the monopoly supplier, and that the introduction of private capital - and by implication the spur to efficiency - would be longer delayed than in the case of the commercial management option.


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(c) Sale of the dockyard facilities

The arguments against this approach - which would achieve full privatisation at the earliest date - are that it would not overcome the problem of the creation of a private sector monopoly supplier, and that it would leave the Government with insufficient control over facilities whose maintenance is vital to the national interest.

(d) Commercial management

This emerges as the preferred option, given that periodic competitions for the management of each dockyard would reduce - if not eliminate - the monopoly supplier problem, while the Government would retain ultimate control over the physical facilities.

6. The OGD does not quantify either the costs or benefits of introducing commercial management. Nor does it quantify the number of redundancies likely to be necessary, although it does refer to a reduction in employment levels, and to the need to alleviate the effects of manpower cuts in Devonport and to encourage new industries to grow there.

The strength of the arguments

7. Ministers now need to take decisions, on the basis of the draft OGD and of Mr Heseltine's earlier paper, on

(i) whether they are satisfied that commercial management represents the best way forward for the dockyards, and

(ii) whether the OGD makes a case for this course of action which will carry conviction with the workforce and in the wider political arena.



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Questions they may wish to examine include

(a) The validity of the arguments against the Trading Fund approach. (Would it be impossible to lift the civil service constraints which tell against this option?

The question may be asked how an approach which yields substantial cost savings could be inconsistent with the Government's general approach to civil service manpower and costs.)

(b) The inadequacy of the Government-owned company approach, which would offer the eventual prospect of full privatisation, with safeguards for vital national interests built into the Articles of Association.

(Could commercial management be relied on to yield major savings very quickly, which could not be achieved by a commercially-oriented management outside the civil service framework?)

(c) The effectiveness of the periodic competition for the management contract. (Once a contractor is installed, there could be heavy transitional costs in a change, and it would be hard to judge his performance over a 4-5 year period in maintaining the dockyard assets and satisfying naval requirements at minimum cost. Although the contractor will have to quote a fixed price in advance for a certain proportion of the work, most naval refitting cannot be specified sufficiently exactly to permit this, leaving much of the dockyard work to be undertaken on some kind of 'cost plus' basis.)

(d) The assurance of the savings to the Defence Budget. (Commercial management will bring increased costs of £35-40 million a year (contractor's profit plus costs of the consumer organisation plus amortisation of the once-for-all initial costs) to set against the efficiency savings. There could be a greater net benefit to the



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public purse if 50-66 per cent of the efficiency improvements were achieved while the dockyards remained fully under Government control.)

(e) The objections to sale of the dockyards.
(Could the Government not rely on the facilities being adequately maintained, as it presumably does in the case of warshipbuilders or manufacturers of military aircraft? The OGD does not mention directly the point that the dockyards serve as operational naval bases as well as facilities for refitting, etc.)

Competition with the Private Sector

8. The OGD does not mention the intention that the dockyards should compete for a certain amount of non-defence work at present done in the private sector. The Sub-Committee recognised the need to ensure that the details of the contract ensure a fair basis for such competition: should this aspect of the Government's plans not be mentioned?

Job Creation

9. Mr Heseltine's earlier paper recognised the importance of linking any decision on substantial manpower cuts with early steps to address the problem of job creation on the lines pioneered by the British Steel Corporation (BSC). The OGD mentions this in guarded terms (paragraph 37). The Sub-Committee regarded the scope for such measures as being relatively limited, and unemployment in Devonport even after redundancies in the dockyard would not reach the levels in the North East or Merseyside.

Legislation

10. Now primary legislation seems likely to be needed under any approach which discontinues the dockyard employees' status as civil servants, and could well prove necessary even in the case of the establishment of a Trading Fund (legislation is planned for the 1985/86 Session to establish an Atomic Energy



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Authority Trading Fund). In considering the 1985/86 Legislative Programme, Cabinet recognised that a place might need to be found for a Royal Dockyards Bill, if the policy were settled in good time (CC(85)7th Conclusions, Minute 5).

If such a Bill were to be included, it might be necessary to drop another Bill in order to make room for it.

HANDLING

11. You will wish to ask the Secretary of State for Defence to introduce his paper. The Secretaries of State for Scotland, Employment and the Environment will have views about particular aspects of the proposals, as will the Minister of State for Trade and Industry (Mr Lamont). The Chief Secretary to the Treasury may wish to give a view on the treatment of privatisation and on the balance of advantage for the public purse.

CONCLUSIONS

12. You will wish to reach conclusions on:

- (i) whether to endorse the commercial management approach to the future of the Royal Dockyards;
- (ii) whether the draft OGD is suitable for publication as a basis for consultation on the future of the dockyards;
- (iii) if so, whether the guarded mention of special employment measures (paragraph 37) is acceptable, and whether mention should be made of the Government's intention to permit the dockyards to compete for a certain amount of private sector shiprepair work.

PLG
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Cabinet Office

20 March, 1985