



P.01344

PRIME MINISTER

British Shipbuilders: Corporate Plan 1984/5-1987/8
(E(A)(84)43)

BACKGROUND

The Ministerial Sub-Committee on Nationalised Industries (E(NI)) discussed strategic issues for British Shipbuilders (BS) in February (E(NI)(84)2nd Meeting, Item 1). BS's warshipbuilding activities have been discussed twice recently in the Sub-Committee on Economic Affairs (E(A)(84)11th and 15th Meetings).

2. At its discussion in February, E(NI) decided that decisions on the future of merchant shipbuilding and the structure of BS must await the production of a corporate plan and other material by BS. This was to include an assessment by BS of the viability of merchant shipbuilding in the United Kingdom (UK) in the longer-term and an assessment of the sensitivity of BS's financial projections to different rates of productivity growth. Provision for BS for 1985/86 in the 1984 Public Expenditure White Paper was to be drawn to the attention of the Chairman, Mr Day, but he was not to be rigorously constrained to produce his corporate plan in conformity with the published figures.

3. At the same time, the Secretary of State for Trade and Industry was invited to open negotiations with the European Communities (EC) with a view to securing an increase in the intensity of Intervention Fund (IF) aid to 30 per cent at a volume of £100 million over two years (it is now thought likely (E(A)(84)43, paragraph 3) that the EC may agree to IF of 25 per cent, perhaps at a lower volume of £70 million over two years).



4. As in February, the BS Board recommend maintaining civil shipbuilding capacity of 200 kcgrt (thousand corrected gross registered tonnes), the first and highest of three Options illustrated then (Annex A to E(NI)(84)3). Option 2 was 150 kcgrt; Option 3, 100 kcgrt. The BS recommendation is intended to "sustain most of the existing merchant capacity to provide a period of relative stability while warshipbuilding privatisation and other restructuring takes place" (E(A)(84)43, paragraph 4). BS propose that closures of large yards should be avoided by making some specialised facilities serve several yards in the North-East and on Clydeside instead of being provided separately at each yard as at present. In effect, this would replace a policy of few, large closures with one of partial closures on a wider scale.

5. The Secretary of State for Trade and Industry, however, argues that the Government should not tie itself to any particular target for manpower or capacity. BS should, however, be required to work within financial constraints, including tough EFLs, calculated to produce an outcome nearer Option 3 than Option 1. He considers that this would nevertheless allow the Government to endorse the approach adopted in the BS plan of "part closures", rather than closure of major yards.

MAIN ISSUES

6. The main issues are as follows.
- i. What should be the future capacity of BS for merchant shipbuilding?
 - ii. How should the target be set?



Commercial Considerations

7. The Board of BS has stated that

"viability, defined as a commercial return on capital employed, is not possible within the plan period" (E(A)(84)43, paragraph 3).

In its view there are no foreseeable circumstances in which such viability can be achieved. Though it would be possible to construct less demanding definitions of viability, it is clear that purely commercial considerations would indicate closure of the merchant shipbuilding capacity of BS.

Non-Commercial Factors

8. Neither BS nor Mr Tebbit recommend total closure. Among factors calling for the retention of some capacity are:

i. Employment

The three options imply the following reductions from the 1984/85 employment figure of about 21,000:

*Option 1 - 9,000 ~~⇒~~
 Option 2 - 12,000
 Option 3 - 13,800

In February, BS estimated that its merchant division and engine builders together employed about 18,500 people.

ii. Regional Considerations

Yard closures would obviously have particular, regional significance. Closures might have serious

* Table 2, E(A)(84)43



implications in particular for the North East. Annex E to E(A)(84)43, which shows the location and workload of each BS merchant yard, illustrates this.

iii. Industrial Relations

BS say that "(Scenario 2 and) Scenario 3 in particular would be likely to give rise to industrial disruption and industrial relations difficulties..." (E(A)(84)43, Annex A, paragraph 7.5). This is no doubt true, not only of Options 2 and 3, but of any significant restructuring proposals.

Future capacity

9. Against this background the Sub-Committee may well feel that the right approach is to run down the merchant shipbuilding capacity of BS as fast as the employment, regional and industrial relations considerations permit. Option 3, a halving of current capacity to around 100 kcgrrt, and a reduction of the labour force by around two-thirds to some 7,000, would seem to meet this requirement.

How to set the target

10. The Secretary of State for Trade and Industry considers however that adopting an explicit target at the level of 100 kcgrrt might have major social and political implications, particularly in the North East. He therefore proposes, while endorsing the broad approach of the corporate plan, to point out to BS that EC considerations and public expenditure constraints call for a volume of production below that implied by Option 1. He proposes, principally by setting tough EFLs, to require BS to adopt a target which would be nearer in practice to Option 3, but which:

- i. would seek to operate by controlling order levels, rather than closing physical capacity on a large scale (E(A)(84)43, paragraph 13);
- ii. would not be quantified in its effects on production or employment; and



- iii. would not necessarily imply departure from the BS preferred option of restructuring through "part-closure" rather than the closure of major yards.
(It would, however, be necessary to sell or close "peripheral" yards at Ailsa and Appledore).

11. This idea has obvious attractions. It could not free the Government from a major share of the responsibility for decisions about capacity and their social, regional and industrial relations effects, but it would maintain pressure on BS to take a full share of the responsibility for such decisions and provide them with a flexible framework in which to exercise their commercial and managerial judgement. The Sub-Committee will also want to satisfy themselves, however, that a restructuring as fundamental as Option 3 could be achieved without major yard closures, in the way described by the Secretary of State; and consider how long it might take to have full effect: there is little detailed information bearing on this in the paper. Also, are Mr Day and the BS Board likely to acquiesce in this approach to the problem?

EC implications

12. The Commission have made it clear that they expect "continuing contraction of both employment and capacity" in return for a further deal on IF. Bearing in mind that Mr Tebbit does not envisage the adoption of an explicit target for capacity and manpower reduction, it may not be easy to demonstrate to the Commission that its conditions will be met. If Mr Tebbit's approach is approved, further work will be needed on how best to handle the discussions with the Commission.

Other matters

13. E(A)(84)43 also mentions three further points on which work is in hand.

i. Combined Provision for IF and Soft Credit

Mr Tebbit says in paragraph 14 iii that he is considering an arrangement under which BS, subject to appropriate ground rules, would be left to manage for themselves a total provision to cover both IF and soft credit. A further report is promised. The most obvious effect would be to make it harder for BS to press "ad hoc" for soft credit to top-up IF terms. This ought to enhance somewhat the financial disciplines on the Board. The Sub-Committee will wish to invite Mr Tebbit to report in due course.

ii. Engine-building

The Sub-Committee will wish to note the action already being taken by BS, described in paragraph 18 in E(A)(84)43 and in Annex F, to restructure engine-building capacity on two sites instead of five; and Mr Tebbit's judgement that it will be desirable eventually, on the order books he foresees, to concentrate engine-building in the UK on one site either at Kincaids or Harland and Wolff. A joint paper by the Secretaries of State for Trade and Industry and Ireland is promised in the Autumn (E(A)(84)43, paragraph 18).

iii. Shipbuilding Redundancy Payment Scheme

This statutory scheme runs out in 1985, a time which may be crucial to privatisation. This raises complex technical and legal questions, as well as the broader tactical one of whether it is better to allow the scheme to lapse, taking the chance that the unions will use the imminence of privatisation as a lever in an attempt to extract



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more favourable terms; or whether it would be preferable to reduce uncertainty, which might have an adverse effect on the market, by extending the statutory scheme for one year. BS are preparing an assessment of the options and their effects on privatisation, which the Secretary of State for Trade and Industry proposes to discuss with the Chief Secretary, Treasury when it is ready: no doubt the Sub-Committee will wish to invite them to report when they have considered it.

HANDLING

14. You will wish to ask the Secretary of State for Trade and Industry to present his paper. The Secretary of State for Northern Ireland may have comments. The Chief Secretary, Treasury will wish to respond. If the Foreign Secretary or a representative attends, he may have points to make on the progress of negotiations with the EC over IF. The Secretary of State for Defence will attend because of his interest in warshipbuilding and should be given a chance to comment.

CONCLUSIONS

15. You will wish to reach conclusions on the following:
- i. whether the capacity of BS for merchant shipbuilding should be allowed to contract over the period to 1987/88 to about 100kcgry;
 - ii. whether targets for the merchant shipbuilding capacity of BS should be set
 - a. explicitly, in terms of capacity and/or employment; or
 - b. implicitly through tough EFLs and other financial disciplines, as proposed by the Secretary of State for Trade and Industry;
 - iii. whether future work on
 - engine-building and
 - the shipbuilding Redundancy Payments Schemeshould proceed as proposed in paras 18-20 of E(A)(84)43.

PLG

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17 July 1984

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