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Treasury Chambers, Parliament Street, SW1P 3AG

The Rt Hon Kenneth Clarke QC MP
Chancellor of the Duchy of Lancaster
and Minister of Trade and Industry
Department of Trade and Industry
1 - 19 Victoria Street
London
SW1H 0ET

22 June 1988

Dear Chancellor of the Duchy,

BRITISH SHIPBUILDERS

Thank you for your letter of 21 June, ^{with G Guice} which I have discussed this morning with Nigel Lawson.

I am sorry that we did not have more time to comment on your proposal. You will recall that on 10 June I asked you to let me know urgently how the negotiations were proceeding so that I could comment before the deal was firmed up. I said then that it was essential that the costs of Intervention Fund support at Govan in the longer term should be taken into account in your costings if it was to be offered to Kvaerner. I said that I doubted that a dowry as high as £30 million could be justified if open-ended IF was to be available. I said also that I thought any IF support to Kvaerner should be on generally available terms, and on the basis of arms length prices as agreed at the Prime Minister's meeting on 31 March.

Your letter does not seem to address these concerns. The further annex which you circulated separately today refers to the costs of IF in the 1990s being uncertain. That does not mean we should ignore them, as your costings do. Also although it is not clear from your letter, I understand that you are proposing an unusually generous form of IF for the first four new orders, which would allow Kvaerner to keep any profit they made on the ships. This seems to me particularly difficult to justify given that the customer for this order will be a consortium in which Kvaerner itself has the major stake. The prices will not therefore be determined at arms length, and

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there is scope for abuse. I am not at all reassured by the notes on this in your additional annex. My officials are not aware of any evidence for the independence of the consortium and the competition from Japan beyond assertions from Kvaerner themselves.

However my main concern with your proposal is that you have not quantified the costs of Intervention Fund support on the fifth and successive new orders at Govan. This is a critical omission. E(A) agreed that continuing IF could be conceded. But we have to cost it properly before we can decide whether the dowry you propose is too high, compared with the £90 million estimate of closure costs. Unless contract support for UK yards had been completely eliminated before further orders were placed, the costs could be very large. For instance, if in 1991 or 1992 Kvaerner placed new orders with building costs of £100 million and the support regime was still at 28 per cent, this alone would push the costs of the Kvaerner deal above your estimate of closedown costs.

Unless, therefore, we can be confident that there will be no Intervention Fund costs beyond the £37 million you identify, the numbers in your letter will not give us a true picture of the costs to which your proposal would expose us.

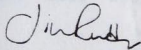
It is only reasonable to exclude the longer term IF costs if you believe that contract support for UK yards will have been eliminated before Kvaerner could seek support for further orders. I am extremely sceptical that the European Commission could achieve this change in policy through EC regulations in that time. They may have a degressive aim under the sixth directive, but they have not achieved any reduction in the support maximum under it so far. Confidence in your costings must therefore rest on the assumption that the UK regime will vary unilaterally within the EC maximum and that regardless of what the EC decides there would be no support for further orders at Govan.

On this basis, I feel I must ask you to reconsider either reducing the size of the dowry, or the possibility of placing a cap on the rate at which Intervention Fund support is payable after 1991 - if the EC has not eliminated it by then.

I should be glad to have a word if necessary in the margins of Cabinet tomorrow.

I am copying this letter to the Prime Minister, Nigel Lawson, George Younger, Malcolm Rifkind and Tom King and to Sir Robin Butler.

Yours sincerely,



pp JOHN MAJOR

(Approved by the Chief Secretary
and signed in his absence).

