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PS/ Secretary of State for Trade and Industry

10 February 1987

David Norgrove Esq
Private Secretary to the
Prime Minister
10 Downing Street
London SW1A 2AA

REA.

Dear David,

AIRBUS

We spoke earlier about recent Press reports, which appeared to suggest that Mr Pattie had said that the Government would agree to provide Launch Aid for the Airbus A330/A340. As requested, I attach a line to take for the Prime Minister's use this afternoon.

Yours ever,
Michael

MICHAEL GILBERTSON
Private Secretary

JG2AUC

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i The proposed A330/A340 programme is clearly very important.

ii However, it is also very expensive, and Government has limited resources.

iii Clearly, the Government is giving the application by British Aerospace for Launch Aid very careful consideration.

iv The Government are aiming to reach a decision as soon as possible in parallel with the other Airbus partner Governments.

v If asked, the Prime Minister should confirm that the Government has not yet taken a decision on the Launch Aid application.

JG2AUE

● **Europe has rallied to Airbus after American claims of unfair subsidies. IAN WILLIAMS reports on the dogfight**

Airbus soars on American anger

TWO SENIOR American trade officials arrived in Europe last week to bang ministerial heads over alleged subsidies to Airbus Industrie, the European plane-making consortium. By the time they left they had scored a remarkable own goal — they had provoked European governments into a ringing endorsement of Airbus — something Europe's aerospace companies had singularly failed to do.

First the two Americans visited Geoffrey Pattie, Britain's industry minister. Airbus "subsidies" were unfair to Boeing and McDonnell Douglas; they were damaging and possibly illegal, the Americans railed.

"They were quite threatening," says Pattie, who does not like being threatened.

By the time the Americans returned to Washington late last week, Pattie had confirmed to The Sunday Times there is now no question but that his department will support Airbus with launch money for its new family of jets — the A330 and A340.

His department's package is likely to go a considerable way towards meeting the £750m request made by British Aerospace, Britain's Airbus partner with 20% of the company. The package will be complete before the end of the month.

Next weekend Pattie will meet ministers from the other Airbus partner countries — France (whose Aerospatiale owns 38%), Germany (Deutsche Airbus owns 38%) and Spain (CASA owns 4%). They will be in Toulouse to finalise their support packages for the new planes, whose development will cost £2.5 billion.

The occasion of their meeting will be Airbus's official roll-out of its new 150-seat plane, the A320, pictured above. With 261 orders and 176 options, the A320 has secured more orders in advance of production than any other aircraft in history.

Jean Pierson, the tough head of Airbus, is expected to use the occasion to announce more launch customers for the A340. Lufthansa (15 plus 15 options) and Air France (seven planes) are the only airlines to have shown their hand so far.

The arrival of the American trade officials last week did not surprise Pattie. Trouble had been brewing for months. The state support Airbus receives is anathema to the Americans. They have totted up $10 billion of it. "And it has not returned a nickel of profit," complained one of them.

As the 17-year-old Airbus consortium has never published any accounts, and keeps financing a closely guarded secret, it is not possible to verify this. But unofficial Airbus sources say support is about half of this level. They also claim that such is the success of the A320, that by the late 1990s it will be able to repay, with interest and profit, its £250m development loan from the British government.

More damaging for Airbus are the accusations that it has been selling its A340 below

Pierson: aggressive selling

Pattie: promising more cash

cost price and has been trying to poach customers that have committed themselves to a rival jet, the McDonnell Douglas MD-11, which was launched late last year.

McDonnell Douglas has claimed that Airbus salesmen offered Alitalia A340s at $10m a time less than anything McDonnell had on offer for MD-11s, and had promised to indemnify the Italians for any penalty they incurred in breaking contracts with McDonnell.

Last week Airbus denied it has been doing anything underhand. One senior source, pointing to the 50-plus launch orders McDonnell has clocked up, said: "A lot of MD-11 orders are not that solid." It is customary, too, for launch customers to get special deals.

Airbus says it is now offering two types of A340. A recent agreement with International Aero Engines for the supply of new fuel-efficient SuperFan engines means customers can opt for a longer-range version, or a shorter range version that carries more passengers.

"Effectively it's now a different plane, so why shouldn't we go back to airlines that have tentative agreements with McDonnell?" asks one source.

Pattie had urged Airbus to cooperate with McDonnell Douglas to take on Boeing, which has 60% of the civil aviation market. Now he says: "The talks may still re-emerge at some stage in the future — over a stretched A340, for instance." But for now he considers the talks closed, and is supporting Pierson in his aggressive search for five launch customers for the A340 by the end of March.

Ultimately, Pattie's irritation with the American officials had a simple basis: he felt they were talking so much poppycock. "It's a tough, competitive business. The sort of activities they complained about are little more than common practice in the airline industry... They just don't like competition."

McDonnell Douglas has its own financing company whose ingenuity in putting together financing packages for the purchase of aircraft has become legend. In one celebrated case in 1983, it whipped an American Airlines order from under the nose of Boeing by fixing up a cheap leasing deal.

And Boeing is no angel when it comes to cross-subsidising planes. Until the arrival of the A340 and MD-11, the Boeing 747 has no competitor in the long-range market. So, effectively Boeing names its price — currently $125m.

Alan Benasuli, aerospace analyst with Drexel Burnham Lambert, the New York investment bank, reckons this means Boeing is making around $20m a plane, or around $700m on last year's sales. As the civil aerospace part of the company is likely to show a 1986 profit of around $300m, it suggests $400m went in supporting the loss-making 767 and 757.

Those figures also show why Boeing is concerned about the likely competition in the long-haul market, and why Pattie thinks it so important to have a European competitor.

Pattie pointed out to the Americans the role of military spending, which, he claims, has supported the development of civil aircraft in America. The 707 was derived from a military aircraft, and the life of the DC10 production line at McDonnell Douglas was extended by military orders for the KC10 tanker, a derivative of the DC10.

Benasuli does not expect America to take punitive trade action against Airbus; it has too much to lose because Europe is an important market for Boeing and McDonnell. Moreover, American engine makers are major Airbus suppliers. Nonetheless, Benasuli does say: "Some kind of trade war is certainly shaping up. It's going to be a blood bath if those two (McDonnell and Airbus) don't collaborate."

THE SUNDAY TIMES 8 FEBRUARY 1987

Billion pound boost to Airbus and Rover

by Ian Williams

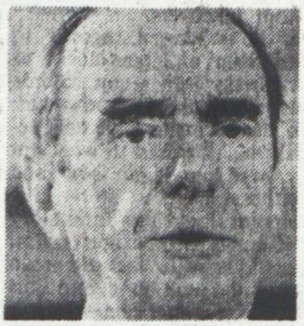
INDUSTRY ministers are preparing plans for a pre-election boost to Britain's aerospace and motor industries which will mean the injection of up to £1 billion of public funds.

Geoffrey Pattie, an industry minister, has decided that British Aerospace must get financial support to remain in Airbus Industrie, the European consortium. He also wants to ensure that Britain participates in the development of a new generation of airliners, the A330 and A340.

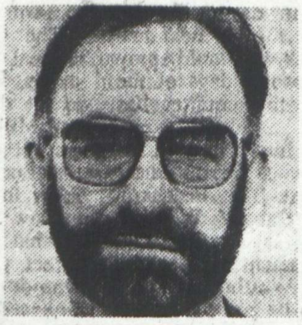
Industry ministers are also in favour of a sanitised version of the Rover corporate plan, presented to them late last year by the Rover boss Graham Day, involving an increase of equity and loans up to £400m.

BAe has asked the government for £750m of repayable launch aid to develop the new Airbus models which will cost £2.5 billion. They are designed to compete with the American giants, Boeing and McDonnell Douglas.

Pattie confirmed to The Sunday Times last week that it is no longer a case of whether his department will support BAe — merely the best way of putting the package together. "We are taking a positive attitude. We are looking at ways in which it can be done," he said. A support package will be ready for discussion elsewhere in Whitehall by the end of the month.



Convinced of backing: Lygo



A stress on continuity: Day

Earlier this week he angrily dismissed American government trade representatives who had flown into London to take him to task over alleged subsidies to Airbus. Hours after the Americans left, Pattie issued his most forthright statement yet in support of Airbus, a statement that has convinced Sir Raymond Lygo, managing director of BAe, that financial support is certain.

BAe reckons a decision to support the A330 and A340 will create up to 12,000 jobs in its factories.

Meanwhile, Rover, the state-owned car group, moved last week to quash any suggestion that its corporate plan, now being considered by ministers, will contain any shocks — least of all any serious job losses in sensitive Midlands marginal constituencies.

By contrast, before Christmas it had implied that the plan would be the most radical yet, with everything open to scrutiny.

The plan is likely to stress continuity. The disposal of peripheral businesses such as Unipart and Leyland Bus to their managements will be highlighted, and the sale of Istel to its management will follow. The trucks business will go to DAF of Holland or Paccar of America.

There will be no plan to dispose of Land Rover this year, and any structural change in the Austin Rover volume car business, particularly involving closer collaboration with Honda, is likely to be deferred.

The plan will have to talk money, however, with the Rover Group likely to reveal losses of up to £250m for 1986. Ministers may resist giving a full £400m which could infuriate backbenchers alarmed at the £4 billion of government loans and guarantees the company has already swallowed.

At the least, a modest cash injection, some debt write-off and an increase in borrowing limits are likely when the plan is published in a few weeks.

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