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P 02536

PRIME MINISTER

The UK National Space Plan: Launch Aid for the Airbus A330
and A340 projects

CONCLUSIONS

The eventual decisions that you will need to take are:-

(i) On Space

- a. to what extent to endorse the UK National Space Plan and the specific actions recommended in paragraph 22 of E(A)(86) 60;
- b. how the cost should be accommodated.

(ii) On the Airbus

- a. whether the Government should agree to help BAe with development costs.
- b. If so, whether the support should take the form of launch aid or interest support.

2. You will no doubt want to reach a preliminary view on these issues at this meeting. But its prime purpose is to decide how best to bring them forward to E(A) for later decision.

BACKGROUND

3. On Space, E(A) was unable to take decisions on Mr Channon's

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proposals before Christmas. The Cabinet Office were asked to prepare a paper reviewing Government expenditure programmes on industrial support and R & D. E(A)(87) 6 is the result. Its intention is to enable Ministers to set the Space bid against other comparable existing and potential claims on resources. The Chief Scientific Adviser has also set out his recommendations on space in E(A)(87) 7.

4. On Airbus, Mr Channon's minute of 24 February covers a voluminous DTI paper. There has not been time to analyse this or discuss it with other Departments. This will be necessary before E(A) meets.

Proposals

5. The two sets of proposals add up to a very considerable bid for new spending. On Space, Mr Channon proposes an overall UK contribution of 14 per cent to the European Space Agency (ESA) programme agreed in January 1985; and a substantial increase in our national programme along the lines of the UK National Space Plan.

6. On the Airbus, BAe asked for help of £750m towards their share, £840m, of the development costs of the proposed A330 and A340 projects. The DTI have suggested instead £336m, rising if necessary to £420m. The public expenditure consequences depend on whether the help is given by launch aid (capital payments) or interest support (borrowing guarantees and interest payments).

7. In addition Rolls Royce intend to ask for £75m launch aid towards the development costs of the Superfan engine, but a decision is not sought on that now.

8. These proposals would produce the following profile of extra public expenditure in the PES period:

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	£ million (Cash)		
	1987/88	1988/89	1989/90
<u>Space (Civil)</u>			
[Present provision]	112	113	119
Mr Channon proposes	+ 75	+125	+170
Mr Fairclough proposes	?	?	+131
<u>Airbus</u>			
Assuming launch aid	+ 45	+ 80	+ 78
Assuming interest support	+ 2	+ 9	+ 16

There are no details of the phasing of the £75m support for Rolls Royce.

COMMENT

(a) SPACE

9. The key issue is whether the benefit to the UK is sufficient to justify spending more on space in the face of all the other competing public expenditure claims. Aside from Airbus, decisions will be required in the near future on additional helicopters from Westland and on the UK contribution to the EC R&D Framework Programme. The Bide Committee have also recommended Government expenditure of £425 million over 5 years (matched by equivalent funding by industry) for a sort of Alvey II programme. Mr Channon tells me that he hopes to accommodate this in his existing provision; but it is not easy to see how, and it is undoubtedly a competing claim with space and other R&D spending.

10. Apart from general considerations (keeping up with the international space Joneses) it is not easy to construct an economic or industrial case for extra spending on space. In particular:-

(a) the returns are speculative and long-term. Mr Channon's Memorandum attempts (Annex D) to illustrate the commercial benefits gained from the UK space programme to date; and Mr Fairclough has identified (paragraph 5 of E(A)(87) 7) several groups who stand to benefit from increases of space expendi-

ture. But the case is far from convincing;

(b) It is not clear whether we have struck the right balance between the UK national programme and our contribution to the ESA. (In 1986/87, the UK national programme amounts to £33m, compared with our contribution to ESA of £80m; the corresponding figures in 1989/90, under Mr Channon's proposals, are £120m compared with £170m). If any more money is to be available, this needs to be looked at more closely in the light of the UK national interest.

(c) There is also the question of the balance between public and private sector funding of space. The private sector share of our total space expenditure is much higher than in most other countries. This is important, since total expenditure, and not just Government expenditure, which matters. (Only in Canada and the UK did the aggregate turnover of the space industry exceed the public sector space budget in 1983).

(d) The costs to the UK of participation in ESA are affected by exchange rate changes, subject to a 2 year lag. This could increase our liability. The UK, like any other Member, can withdraw from particular ESA programmes if forecast expenditure on that programme is due to exceed total provision by more than 20 per cent. But in practice such withdrawal is always difficult.

(b) AIRBUS

11. As stated above, we have not yet had time to examine these papers in detail. The main reasons stated for giving support are:

a. The project will go ahead even if BAe refuse to participate. The French and German Governments have decided in principle to support their share of the costs.

b. Our withdrawal would be criticised by our partners. You have yourself told Chancellor Kohl that it made sense to develop Airbus further to maintain an independent European capability.

c. Withdrawal would damage BAe's long-term future. They say that it would lead to closure of plant at either Filton or Chester.

12. The main argument against giving support is the poor rate of return on the project. BAe estimate it as 9.4 per cent in money, which, assuming 4 per cent inflation, only just meets the 5 per cent real return applied to low risk public sector projects. The return could be lower than this if the exchange rate is higher than the assumed \$1.30 or if the Airbus fails on price or other grounds to compete with the alternative Boeing and McDonnell Douglas aircraft. Because of these poor prospects, private sector lenders have declined to finance the project. The US may also seek to cause further trouble.

13. As to the choice between launch aid and interest support:

a. Interest support substantially reduces the cash outflow in the early years (see Table in Paragraph 8 above).

b. But it means undertaking a large contingent liability of uncertain size. It could also be embarrassing in the GATT context and with the Americans.

The DTI recommend launch aid. The Treasury would prefer to leave the choice open for the time being.

Finding the Money

14. Mr Channon cannot realistically find any significant extra amounts from within his present PES. Unless, therefore, there is to be a net increase in public spending, any increased spending on

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space or Airbus will have to come from other programmes. The Departments which currently contribute to our civil space programme (DTI, MoD, and DES) are unwilling to divert expenditure from their own programmes to fund additional space expenditure, although they would continue to have an interest in any expanded programme. (See Annex A for Departmental contributions in 1986/87). Mr Baker has told me that he is opposed to any substantial extra spending on space; and I am sure that Mr Younger will argue that the Defence Budget cannot provide any more. The Chief Scientific Adviser has suggested that the principal candidates for contributions are the nuclear programmes of the Department of Energy, agricultural R&D or a transfer from the Defence Budget. These are clearly worth considering in the longer term; but I fear there is little prospect of finding much in the immediate future. The only alternative would be to raid the Reserve - which the Chief Secretary will be equally keen to defend. You will, however, want to use this meeting to test the Chief Secretary's position.

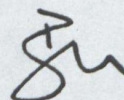
NEXT STEPS

15. Mr Channon's view is that a decision by the end of March would suffice. It should therefore, be possible to bring both Space and the Airbus to E(A) for decision in the week beginning Monday, 9 March (Mr Channon will be away next week). The position on helicopters might also be clearer then (at least to the extent of whether or not MOD and/or DTI are bidding for extra funds). You may, therefore, wish to ask Mr Channon to bring his combined paper forward to E(A), revised as necessary, that week. In doing so, it may be advisable for him to consider whether he could take space forward on the basis of a much smaller addition to be present programme than he presently seeks. I doubt whether in practice the situation is as "all or nothing" as his minute claims.

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HANDLING

18. You will wish to invite the Secretary of State for Trade and Industry to present his proposals. The Chief Secretary, Treasury will wish to respond. You will want the views of the Lord President and the Chancellor of the Duchy on the handling and presentation generally.



J B UNWIN

Cabinet Office
25 February 1987

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ANNEX A

Provision for 1986/87 for UK's ESA contribution and the
national programme

	£m	
	ESA Contribution	National Programme
DTI	48	12
SERC	16	12
Met Office	7	2
MoD		4
NERC		1