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Prime Minister
A useful round-up
CDP 27/4

TO:

PRIME MINISTER

FROM:

KENNETH CLARKE

27 April 1988

AIRBUS INDUSTRIE

1 I understand from David Young that you had a brief discussion with Sir Jeffrey Sterling on 21 April about the current position within Airbus Industrie (AI). It might be helpful if I explain where we are on the main issues.

— see top of file

2 I start from the position that the original decision to set up AI in the way it is now structured was highly questionable. I strongly support the idea of European collaboration but this only makes sense where there is a properly defined management structure that can take a clear view of the market and act in a fully commercial manner. By contrast, AI is at present just a marketing organisation without any proper control over costs and with no clear lines of responsibility. The problem is compounded by close Governmental involvement. Three of the partner companies - MBB, Aerospatiale and Casa - are either state-owned or heavily dependent on the state. In the case of

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the fourth, British Aerospace, we are heavily committed through what I regard, with the wisdom of hindsight, as rather unwise decisions to provide launch aid for the A320 and, more recently, the A330/A340.

3 In an attempt to improve matters I have been devoting a great deal of my time to tackling what I regard as the three key issues:

(a) the management structure of AI;

(b) possible collaboration with McDonnell Douglas; and

(c) possible trade action by the US.

The first Airbus meetings I attended with our partners were badly organised, inconsequential affairs and I was very pessimistic about the likely outcome. Fortunately the prospects for a satisfactory resolution of each of the issues has improved significantly since the beginning of this year.

Management Structure

4 I believe Sir Jeffrey Sterling has already given you a copy of the so-called Four Wise Men's Report. I think Sir Jeffrey has done an excellent job in getting a report that makes clear

recommendations on essential improvements in the management structure, decision-making and financial position of AI. These were discussed by Ministers of the partner Governments together with the four wise men, AI and the four companies at a meeting in Madrid on 12 April. There was, in my view surprisingly, full agreement to the principles underlying the recommendations in the report. AI and the four companies were asked to prepare detailed recommendations for the next Ministerial meeting on 5 May in Hanover on how to implement the Report's conclusions by the end of this year.

5 Proposals from the companies are an essential next step. I doubt that we can expect them to be as helpful as we want. I am, however, determined to see the present system reformed. In due course this will require changes in some of the senior personnel, including the President of Airbus Industrie, Herr Strauss. There may be a tough battle about this. It is not, however, a first step but rather something that I think we can ensure will follow once the partner Governments have agreed the necessary structural changes.

6 Whatever the pace of change within AI - and I shall certainly continue to press vigorously for the earliest possible changes - there will inevitably be significant further losses as AI try to maintain, if not increase, their market share through selling A320s against an adverse $US exchange rate. I am in

close touch with BAe. They made a £320m provision in their latest accounts for prospective losses on civil aircraft, including £180m on Airbus. Their main concern is continuing to develop the A330/A340 while losses are still being incurred on the A320. Professor Smith has told me that his Board have concluded they may be forced to withdraw from the A330/A340 if the present exchange rate and AI cost inefficiencies do not improve. In my view this is a problem best tackled through potential collaboration with MDD. If BAe were to withdraw there would be unwelcome financial implications for the Government - and of course a major political row with our partner Governments in Europe - because of the guarantees we have given (my paper E(ST)(88)5 refers).

Collaboration with McDonnell Douglas

7 There is arguably room for only two major civil aircraft manufacturers in the Western world rather than the three we have at present. Boeing is the clear market leader, particularly with their 747 where they currently face no competition. MDD is supported through its military work but they are facing difficulties on the civil side. I believe that MDD and Airbus will only thrive if they combine their product range and tackle Boeing together.

8 There is potentially significant scope for collaboration between MDD and AI. They are both working on a similar range of wide-bodied and narrow-bodied aircraft. I particularly want to concentrate on the wide-bodied (A330/A340) range, including looking at the options for competition with the 747. If the companies can produce a common product range based on variants for the A330 and the MD-11, this could open the way to a full reappraisal of the case for an A340.

9 AI are in the lead on negotiations with MDD. Progress was reviewed at the Madrid Ministerial meeting. There was general agreement that prospects for collaboration were better than at any previous time and genuine progress seemed to have been made. I shall continue to press for an early positive outcome although I remain to be convinced that all the European participants genuinely want the negotiations to succeed. Herr Strauss is very opposed to the whole idea on "European" grounds.

Trade Negotiations with the United States

10 Here too we have made significant progress since last Autumn. The essential US argument is that AI is unfairly subsidised. The AI partner Governments have maintained that the US companies, Boeing and MDD, benefit from research and military funding but in my view there can be little doubt that the US claim can be made with some justification.

11 The potential consequences of a trade action initiated by one of the US companies would be enormous. The French and Germans still do not appreciate this adequately. I think I have persuaded the Germans at least to take a more reasonable attitude. Tensions have also been eased by the weakening of the $US and the resultant advantage to the US companies. However the American market will remain difficult for Airbus until the dispute is resolved. I am quite sure that the US Government would now like to bring the matter to a satisfactory conclusion prior to the final run-up to the Presidential Elections. I shall be trying to achieve this over the next few weeks but the French position remains belligerent and unhelpful.

Conclusion

12 I will report further developments after the Hanover meeting on 5 May. It might then be helpful for us to have a meeting.

13 I am copying this minute to Geoffrey Howe and Nigel Lawson, and to Sir Robin Butler.

KC

AEROSPACE : Airbus Pt 3