

P. 01226



PRIME MINISTER

Harland and Wolff Limited:

Strategy and Funding

(E(NI)(84)2)

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BACKGROUND

When the Ministerial Sub-Committee on Nationalised Industries last discussed Harland and Wolff (H & W) in July 1983 they decided:

- that the company strategy should be considered later on the basis of a further analysis of the Corporate Plan;
- that future orders for H & W should not be sought on terms more generous than those available to British Shipbuilders.

2. In his memorandum E(NI)(84)2 the Secretary of State for Northern Ireland describes the strategy proposed by the H & W Chairman, Mr. Parker. The main thrust is to increase the level of shipbuilding activity by winning orders for a wider range of vessels of medium size and sophistication; and to reduce both overhead and operating costs. Similar expansion and cost cutting objectives are set for the engineering and shiprepair divisions of the company. On the basis of the assumptions about costs and prices underlying the strategy, the External Financing Limits (EFLs) are projected at around £40 million per annum over the next three financial years. It is also estimated that to bridge the gap between world prices and H & W's costs, so the company can win ship orders, assistance from the Government's Intervention Fund (IF) of £20 million per annum and at rates up to 35 per cent will be required.

How?

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The amount and rate of IF assistance is subject to European Community (EC) approval.

3. Following correspondence between the Chief Secretary and Mr Prior, a study by consultants of a different strategy based on a smaller yard has been set in train. This should be ready by mid-summer. The Chief Secretary sees this as a potentially desirable alternative; Mr Prior regards it as a fall-back, should the Parker strategy be blown off course.

4. Mr Prior therefore asks the Sub-Committee:

a. to note the current strategy and endorse the general thrust of internal efficiency measures;

b. to note that a smaller yard option is being examined;

c. to agree, on a provisional basis, to an EFL of £37.6 million for 1984-85;

d. to agree that EC approval should be sought for IF assistance at a rate of up to 35 per cent and a level of £20 million per annum.

MAIN ISSUES

5. The main issues are:

i. whether the Sub-Committee wishes to reach any conclusions at this stage about H & W's future strategy;

ii. whether any agreement should be reached at this stage on H & W's EFL for 1984-85;

iii. whether EC approval should be sought for Intervention Fund assistance at a rate of up to 35 per cent and at the level of £20 million a year.

Strategy

6. The Chief Secretary has challenged the current strategy of H & W as described in E(NI)(84)2 and Mr Prior has accepted that a smaller yard strategy should be explored although he says that this will not be ready until mid-summer. The Sub-Committee will not therefore wish to endorse the H & W strategy at this stage.

7. The Sub-Committee may however wish to note that the current strategy rests on some optimistic assumptions. It aims to increase activity mainly by winning orders for ships of a type and size largely outside the company's experience, in direct competition with BS yards. The gap between H & W's cost and world prices is about 40 per cent. H & W's ability to win orders appears to depend on a continuing very high level of subsidy. Mr Prior admits (paragraph 6 of E(NI)(84)2) that the case for the preservation of H & W rests on political grounds and does not think that closure can safely be considered unless job creation accelerates to a point where the political arguments begin to lose their force.

8. Whether it is tolerable to defer until mid-summer the discussion of a smaller yard strategy for H & W depends in part on the timing of decisions about the future strategy of BS. Ideally it would be better to take all the strategic decisions about the future of UK merchant shipbuilding at the same time and the Sub-Committee is likely to wish to take strategic decisions about BS much earlier than mid-summer. It may therefore be worth pressing Mr Prior to consider whether it might not be possible to put a paper on a smaller yard strategy for H & W to coincide with Mr Tebbit's further paper on BS merchant shipbuilding strategy. This should identify options for progressively reducing the cash subsidy to H & W on a broader and more realistic range of assumptions about costs and market developments than those considered in E(NI)(84)2.

  
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External Financing Limit 1984-85

9. In his memorandum Mr Prior suggests an EFL or £37.6 million for 1984-85 but on a provisional basis and to be kept under review. The basis of the figure is not fully set out; but the timing of an expected order could have a major impact on the EFL.

10. The Sub-Committee's discussion may be influenced by their decision on whether or not to settle now the 1984-85 EFL for BS, on the timing of the strategy discussions for BS and H & W, and on whether a higher intensity of IF assistance is to be sought for H & W than BS.

11. While Treasury Ministers may prefer to postpone a decision on the 1984-85 EFL for BS, they are understood to see advantage in settling the 1984-85 EFL for H & W, and to do so on a firm rather than a provisional basis. This is because they fear that agreement on a strategy to contract H & W is less likely and more remote in time than an agreed strategy for contracting BS. A tight EFL for the next financial year is thus the only discipline available at present for restraining expenditure at H & W and in particular for maintaining the pressure on cost savings. Despite therefore any apparent logical inconsistency with what may have been decided about BS, there may be advantage in settling H & W's EFL firmly at £37.6 million in advance of settling the future strategy for H & W. A later revision in the light of the strategic discussion would always be possible.

12. If the Sub-Committee were to decide (see below) that the level of IF assistance for H & W should not be 35 per cent but 30 per cent to keep it in line with the level of assistance to BS, Mr Prior may argue that the EFL would need to be increased so that H & W could offer more soft credit, as a means of securing orders. The Chief Secretary would resist this

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arguing, inter alia, that the level of IF assistance should in any case have little effect on finances in 1984-85.

Intervention Fund assistance

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13. Mr Prior is proposing IF assistance of £20 million a year at a rate of 35 per cent, compared with the rate of 30 per cent which Mr Tebbit has proposed for BS. Mr Tebbit has argued (paragraph 9 of E(NI)(84)3) that "we must secure comparable treatment between BS and H & W for comparable ships". This probably implies a continuation of the present arrangement under which H & W is allowed a higher level (at present 18 per cent) for vessels of over 100,000 dwt in which BS does not compete but has the same rate (at present 15 per cent) for the smaller vessels. The Sub-Committee will recall that it agreed when it last discussed H & W on 28 July that: "future orders should not be sought or taken (by H & W) on terms more generous than those which would be available to BS" (E(NI)(83)7th Meeting, Item 2).

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14. There are therefore two problems: the difficulty of seeking EC approval for a doubling of intensity of IF assistance without a clear statement of future strategy which applies equally to BS and will have been discussed under that item; and the question of how far a higher level of IF assistance should be allowed for H & W than for BS.

15. On the second point the Sub-Committee may well feel that, if, as is proposed, H & W is to compete to a greater extent with BS in the market for smaller vessels, it would be hard to justify a higher level of subsidy for H & W on the same range of vessels. They may however be prepared to contemplate a higher level of subsidy on the larger vessels.

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HANDLING

16. You will wish to ask the Secretary of State for Northern Ireland to introduce his paper. The Chief Secretary, Treasury will wish to comment on public expenditure considerations and the Secretary of State for Trade and Industry on how the proposals for H & W fit in with the proposals for British Shipbuilders. The Minister of State, Foreign and Commonwealth Office (Lady Young) may wish to comment on the Community implications.

CONCLUSIONS

17. You will wish the Sub-Committee to reach conclusions on the following:

- i. whether the future strategy for H & W should be reconsidered with the opportunity to consider a smaller yard option
  - in mid-summer on the basis envisaged in E(NI)(84)2, or
  - at an earlier date, possibly to coincide with the discussion of the future of BS's merchant shipbuilding activities;
- ii. whether an EFL of £37.6 million for H & W for 1984-85 should be approved; and, if so, whether on a firm or provisional basis;
- iii. in the light of the corresponding decisions affecting BS, when EC approval for the future level of IF assistance for H & W should be sought;

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iv. whether the maximum subsidy should be set at the same rate as that decided for British Shipbuilders; or

v. whether EC authority should be sought for different levels of maximum subsidy where British Shipbuilders and Harland and Wolff were not in direct competition; and, if so, what that rate should be.

*PLG*

P L GREGSON

17 February 1984

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