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MINISTERIAL COMMITTEE ON ECONOMIC STRATEGY

BRITISH SHIPBUILDERS FINANCES

Memorandum by the Secretary of State for Industry

British Shipbuilder's (BS) cash needs exceed this year's External Financial Limit of £120 million by £65 million and the PES provision for 1981/82 of £81 million by £50 million. These figures are now irreducible for 1980/81 and largely so for next year, because they represent payment of past losses, the unwinding of favourable balances at the specialist warship-builders [£35m in 81/82; £45m in 82/83], and the fact that BS's yards for the most part have got loss making contracts extending through the 2 years which have to be completed to avoid greater losses.

2. Details of BS's strategy and the financial implications are set out in the attached annex by officials. This paper is concerned with the main theme namely:

i Should we accept BS's new strategy of concentrating merchant ship production at fewer establishments but keeping it at near the same level. Should we let them diversify further into oil drilling rigs at a probable loss.

ii Should we insist on further closures albeit at a high price in 1981/82 and 1982/83 to reduce the risk of exposure to endless high subsidies. The closures could not take place until 1982.

Progress so far

3. BS have successfully slimmed employment in merchant shipbuilding from 36,000 at vesting day to around 16,700 by the end of this year and have reduced the number of yards. For our part, we have achieved a steady reduction of subsidies. The Intervention Fund has been reduced from £65 million last year to £55 million and the rate of subsidy per ship has been cut by 7 percentage points. Should we decide on a further tranche for a year on the expiry of the present tranche in July, we propose to reduce it to £45 million for a year and cut the rate by say 5 percentage points. The cost escalation scheme for merchant ships has been terminated. Degressivity on subsidies has thus been combined with a reduction

/in employment ...

in employment and physical capacity.

4. BS's trading loss forecast this year of £110 million before subsidies while far too high is much less than last year - £174 mill on the same basis. BS have suffered from a weak market, from the hi exchange rate particularly against the yen - which more than negated benefits of a well below average wage settlement (11½% on an annuali basis) - the steel and engineering strikes, and the delays and cutba in Naval orders which they were counting on. They can justifiably point to the face that all these factors are outside the control of t Corporation.

5. On the other hand, BS have failed to make significant improvement in productive efficiency and they have missed their financial targets by large margins. The new Chairman has taken an immediate grasp of affairs, but nevertheless if we want to make further reduction in the of BS continuing to incur losses beyond that offered in their strateg reliance on financial discipline alone could be risky and we might have to insist on further closures in 1982.

BS's Preferred Strategy

6. BS are not now expecting any major naval orders for their mixed yards because of the severe cutback in naval requirements. They als recognise that the amount of Intervention Fund will be insufficient to support all their yards if the cutback in naval requirements is t be replaced by merchant shipbuilding. They, therefore, plan to diversify at Cammell Laird and Scott Lithgow into oil rigs - which ar not eligible for IF assistance - albeit at an initial loss of up to per rig, and thus deal with the difficulties posed by the contraction naval requirements. They are prepared to contemplate the closure of Smiths Dock.

7. The advantage of this strategy is that it does remove considerabl actual or potential capacity from shipbuilding. BS is prepared to say that neither Cammell Laird nor Scott Lithgow will be eligible for Intervention Fund assistance. Their future would be dependent on naval work and oil rigs. If Smiths Dock is closed as well this would

/ remove ...

remove from merchant shipbuilding capacity of about 130,000 grt. British Shipbuilders' merchant ship output would thus be concentrated in fewer establishments and should allow full utilisation of capacity.

8 It is, however, open to question whether BS will be any more successful in diversifying into oil rigs than they are on merchant ships. Market prospects are, however, somewhat better than for merchant ships where the market is dominated by Japanese competition.

Oil Rigs

9 BS wish to diversify into oil rigs at Cammell Laird and Scott Lithgow at an initial loss. Without such orders both Cammell Laird and Scott Lithgow would be solely dependent on their naval contracts, which provide insufficient loading. In this event, we would have to face up to the eventual closure of either or both. Closure costs could amount up to £120 million which BS have not provided for. If BS do not get these rig orders, the orders will go abroad.

10 While these are powerful considerations, I think we shall need to examine each order carefully in the light of the yard's performance, and the defence and social implications until BS can take such business at a profit. The new Chairman certainly intends that this should become profitable. We shall make it clear to the Chairman that support for further orders will depend upon progress towards viability.

Further Cuts

11 As indicated above, BS are prepared to contemplate the withdrawal from shipbuilding of some 130,000 cgrt, although they have not yet taken a final view on Smith's Dock.

12 Potential output would, however, still be high at some 360,000 tons a year because higher output would be concentrated at fewer establishments. The case for further cuts turns essentially

/on whether ...

on whether BS's forecasts of improvements are credible, and whether it would be better to make a further contraction in merchant shipbuilding because essentially merchant shipbuilding both in this country and the whole of Europe has been a loss making activity for very many years. There is no economic sense in a continuing regime of very high subsidies and loss financing.

13. The argument for not insisting on further cuts is that the cuts proposed are as far as we can and should practically go. We have followed a policy of degressivity and contraction in the industry and BS's new strategy is in line with it.

14. If we insist on yet further cuts, the scale of the withdrawal from merchant shipbuilding will be very great indeed. Even if they were limited to say 50,000 cgrt it would entail a withdrawal of some 180,000 tons from merchant shipbuilding. It would be against the advice of BS, and the effect on BS, their morale and productivity has to be taken into account. Any cut decided upon by Government will appear arbitrary and be difficult to defend. Moreover, BS also are proposing either the sale of their major shiprepair interests insofar as the constraint of their statutory duties allows, and the new Chairman has indicated that, if buyers cannot be found, further contraction, particularly at Vosper Shiprepair which is heavily loss making, will take place.

15. The shipbuilding industry has had six years of depression and the reduction in capacity throughout the world has improved prospects and the demand for ships is improving. As far as BS's credibility is concerned, they have a new Chairman who has already acted to cut overheads and our impression so far is that he can bring the industrial leadership and financial discipline which BS needs.

Other Decisions Needed on Shipbuilding

16. In the light of colleagues' decisions on strategy towards the industry, we shall need to decide on:

/An ...

a) An extension of the Intervention Fund after the expiry of the present tranche of £55 million in July 1981. Such an extension might comprise a new tranche of £45 million for one year with the rate of subsidy reduced by say 5 percentage points.

b) An extension of the Redundancy Payments Scheme which expires in June 1981 which, in my view, should be extended for two years. The case is the uncertainties in the industry. New legislation is required.

Financial Implications

17. The cost of BS's proposed strategy in terms of Intervention Fund (part of Programme 4) and BS finance (Programme 5) are:

	1980/81	1981/82	1982/83
PES Provision	104	82	38
BS Forecast	161	130	70
Plus costs to BS on closures of Smith's Dock and Vosper	3	7	5

18. If Smith's Dock and Vosper were to close redundancy payments on the assumption that the shipbuilding Redundancy Payments Scheme is extended and including payments under the Redundancy Payments Act might total £13m. There might also be additional contraction/restructuring, for example at Cammell Laird or Scott Lithgow if they cannot get sufficient offshore orders but there is no basis for estimates.

/Privatisation ...

Privatisation

19 We agreed in August that the privatisation of British Shipbuilders in whole or in part should be deferred (CC(80)32nd Item 3).

20 It is my intention to look again at this matter during the ne year in the light of the progress which Mr Atkinson makes in streng ing the industry and disposing of BS shiprepair and engineering interests.

21 The proposals in this paper for further reduction in subsidie the progress towards viability of yards retained for merchant ship- building and diversification into offshore should make all the yards less unattractive to the private sector.

Conclusion

22 On balance I believe that we should back BS's preferred strat This would be in accordance with our general strategy towards the industry announced a year last July which looked forward towards th possible future viability of the industry whilst accepting that its size is dependent on progress made and that we should follow a degressive policy in subsidies.

23 Progress towards viability by the industry has not been good enough, and hence a further reduction in merchant shipbuilding and shiprepair has been accepted by BS in their new strategy.

24 I ask colleagues to agree:-

(a) The general strategy towards BS.

(b) An extension of the Redundancy Payments Act for a further two years.

(c) E(EA) might consider detailed aspects of the Interventi Fund.

K J

Department of Industry
12 September 1980

SHIPBUILDING REVIEW

Note by Department of Industry Officials

INTRODUCTION

Slightly over a year ago the Government announced a framework of support for the industry until March 1981 and BS, for their part, began a reduction of merchant shipbuilding capacity from around 600,000 compensated gross registered tons (cgrt) to about 400,000 cgrt in 1980/81 and a reduction of employment in merchant shipbuilding from nearly 28,000 to around 18,000-19,000, which was subsequently reduced by a further 1700.

2 BS's contraction target should be achieved by the end of the year. It now looks as if the total merchant shipbuilding output will be about 320,000 cgrt this year with employment at the end of the year at 16,700 on merchant shipbuilding. Details of the contraction of employment are at Annex I.

3 On the other hand, BS's cash needs exceed this year's External Financial Limit of £120 million by £65 million (at 1980 cash prices) and the PES provision for 1981/82 of £81 million (at 1980 survey prices) by £40 million. BS are also forecasting this year's loss target will be missed by £20 million.

4 A major problem is the size and inflexibility of BS's dependence on public expenditure. The cash requirements this year and next cannot be reduced because they reflect past losses, the unwinding of favourable balances at the warshipbuilders and the fact that BS are locked into loss making contracts.

5 BS wish to reduce the notional capacity for merchant shipbuilding by cutting the number of establishments, but they aim in particular to maintain output by better capacity utilisation. The main question for consideration is whether BS's strategy should be accepted or whether, in the light of BS's financial performance and prospects, merchant shipbuilding output should be reduced and, if so, by how much and by what means. Further closures involve higher public expenditure in the short term, particularly in 1981/82 and 1982/83 but reduces possible exposure to continuing high losses and subsidies in the longer term.

BS's Preferred Strategy (Option A)

6 BS's preferred strategy is to take Scott Lithgow and Cammell Laird out of merchant shipbuilding and build up merchant ship production at Swan Hunters where no significant naval orders are expected in the period. The future of Cammell Laird and Scott Lithgow would thus be in naval and offshore, but both Cammell Laird and Scott Lithgow would need to take offshore orders initially at a loss. If pressed, BS would also probably agree to close Smiths Dock when its workload expires at the end of 1981. The net result of this strategy would be to reduce merchant ship capacity by 130,000 tons. While Cammell Laird has no merchant ship orders at present, it has a nominal capacity of some 50,000 tons.

7 In addition, BS will endeavour either to sell its major shiprepair interests or will restructure them to avoid losses. Vosper Shiprepair which is heavily loss making is at risk of closure.

8 The effect of these changes is to reduce substantially the risk of underutilisation

9 If Ministers decide to back BS's new strategy it is suggested that they should insist on the closure of Smiths Dock. The yard needs substantial capital expenditure which cannot be justified. Details of this Option are set out in Annex II.

Cost

10 Cost of this Option in terms of Intervention Fund (part of Programme 4) and BS's finance (Programme 5) are:

	1980/81	1981/82	1982/83
PES Provision	104	82	38
BS's forecast	161	130	70
Plus possible costs to BS on closures:			
Smiths Dock) Vosper }	3	7	5

If Smiths Dock and Vosper were to close, redundancy payments on the assumption that the Shipbuilding Redundancy Payments Scheme is extended and including payments under the Redundancy Payments Act might total £13 million. There may also be a need for other contraction but this cannot be forecast or quantified at this stage.

Other Options

11 As alternatives to backing BS's strategy, Ministers may wish to consider:

i Providing no more support to BS to obtain orders and let the merchant shipbuilding industry run out of work on the ground that it is too expensive together with shiprepair if it has not reached breakeven - Option B.

ii Accepting BS's strategy but refusing BS the money to enter the offshore market at a loss. This could entail a progressive rundown of either Cammell Laird or Scott Lithgow or both - Option C.

iii Authorising the money for BS's offshore plans but insisting on a further cut in merchant shipbuilding capacity additional to that proposed in their strategy to reduce the risk of exposure to further high losses and cash requirements - Option A.

No Further Support (Option B)

12 It is not possible to close yards now because existing commitments have to be fulfilled. If it were decided not to provide support for new orders, this would become public knowledge and lead to industrial and social unrest. The cost is incalculable since widespread closures would lead to disruption to the naval programme as well as extremely high losses on merchant contracts. BS have estimated that to close the worst loss makers with a capacity of around 168,000 cgrt, additional losses of £168 million would be incurred on existing contracts assuming only a six months slippage

and additional redundancy costs of £84 million. A twelve month slippage would be more probable giving rise to £216 million losses. This does not take into account any wider effects on the industry.

13 Moreover, a policy of shutting down the industry completely t no account of the fact that progress has been made. Rates of subs have been reduced and the current high cash requirements spring fr past losses when yards were underutilised. They now have reasonab satisfactory orderbooks, and it would be perverse to abandon the industry now particularly taking into account the following consid ations which influenced the Government in providing assistance at t height of the recession last year.

i A number of fully modernised yards could have a viable future and indeed the Chairman of BS is confident that the Corporation, as a whole, will be viable given time.

ii All the large merchant and mixed yards are in areas of high to severe unemployment. Until there is growth in the economy there is a social case for providing a chance for part of the industry to survive.

iii The Ministry of Defence finds it advantageous to have mixed yards to provide flexibility in naval shipbuilding capacity.

iv There is a limited Defence interest in having a merchant shipbuilding capacity to provide resources for shiprepair in the event of war. The preservation of UK shiprepair capacity outside the Royal Dockyards provides flexibility of capacity to meet the fleet's varying support requirements. The extent to which the MoD will require to make use of that capacity will depend on a number of factors, not the least of which will be the outcome of the consideration which continues to be given to the future of the Royal Dockyards.

v There is an advantage to the UK shipping industry in having a home building capability if the industry produces at or near world prices and it may also be argued that there are general strategic grounds for maintaining such a capability.

14 Reducing subsidies appreciably faster than BS's competitors is also equivalent to no support.

Accept BS's Strategy by refusing to support offshore Diversification (Option C)

15 Unless Ministers wish as a matter of principle to tell BS that they must not quote at loss, it would probably be best to reach decisions on individual cases. An assessment by OSO of the market is at Annex III. BS's present assessment is that they cannot obtain the orders except at a loss unless the market continues to improve. Only BS in the UK has the capability of undertaking this work, and if BS are not allowed to take the work it will go abroad.

16 If BS cannot get the work or are refused finance for it would entail on MoD's present order requirements the closure of either Scott Lithgow or Cammell Laird or both. These are mixed yards and the closure of both would have implications for Defence capability. Furthermore, to close two such major yards in areas of very high unemployment would risk disruption to the remaining naval programme of the two yards. The cost of closure on a 6 months slippage basis, taking the unlikely assumption that there would be around £90 million including redundancy payments and closure could not be effected until 1986/87 in the case of Cammell Laird and 1984/85 in the case of Scott Lithgow. The time required for closure reflects the need to complete existing MoD's contracts, and closure costs could be higher - £120 million assuming a 12 month slippage on orders.

Closure of Additional Capacity (Option D)

17 If Ministers wish to increase the amount of shipbuilding capacity to be withdrawn from merchant shipbuilding beyond the 130,000 cgrt, withdrawn under BS's new plans, it would be against BS' advice and it

would be difficult to defend the size of the additional cutback against attack. It would appear an arbitrary cutback. To go beyond BS's plans would risk a collapse of morale in the industry and be counterproductive in achieving improvements in financial performance.

18 It should be noted, moreover, that small yards which have hitherto been to some degree reliant on MoD work, for example, Clelands will be vulnerable as a result of MoD's reduced requirements. Brooke Marine, for example, cannot survive unless it gets substantial naval exports. There are thus considerable uncertainties, particularly in the light of a degressive policy on subsidies.

Other Decisions Needed

19 Ministers need to take decisions soon on the extension of the Intervention Fund and the Redundancy Payments Scheme.

20 An extension of the Intervention Fund might comprise a new tranche of £45 million for one year with the rate of subsidy reduced by say 5 percentage points after the expiry of the present tranche of £55 million in July 1981. BS say that this would be compatible with their strategy. Such an extension would accord with the Government's degressive policies on subsidies.

21 In view of the uncertainties in the industry, there is also a strong case for an extension of the Redundancy Payments Scheme. Details are set out in Annex V. New legislation is required.

Summary

22 It is not practicable or cost effective to withdraw subsidies from BS. Ministers need to decide:

a) Whether to accept BS's strategy subject to the proviso that it should include the closure of Smiths Dock (Option A) in addition to the withdrawal of Scott Lithgow and Cammell Laird from merchant shipbuilding.

b) Whether to allow BS to diversify into offshore activity at a probable loss.

c) Whether to insist on BS drawing up plans for additional contraction, and if so, to decide on the extent of any further contraction which appears desirable. Any such contraction in major yards could not take place until probably 1982.

BS EMPLOYMENT FIGURES (ROUNDED)

Type of activity	July 1977	June 1979	mid-1980 target	end-June 1980
Merchant shipbuilding	38,600*	27,900	16,800(i) (approx)	17,250*(ii)
Naval	26,300*	31,600*	–	30,700*
Offshore supply	200*	1,150*	–	2,300*
Shiprepair	8,500	6,400	–	5,400*
Marine Enginebuilding	6,200	5,200	–	4,500
General Engineering	6,300	7,100	–	7,100
Others	1,300	900	–	2,750*
TOTAL	87,400	80, 250	–	70,000

*employment at the merchant and mixed yards is allocated to type of activity (merchant shipbuilding, naval shipbuilding, offshore, shiprepair, other activities). Figures for 1977 and 1979 were allocated among the first three categories only.

(i) BS's contraction programme for merchant shipbuilding was a reduction from 27,900 to 18,000-19,000 by mid-1980. Th was later accompanied by a further planned reduction of in all BS's activities (of which about 1,700 were to com merchant shipbuilding) as part of the March 1980 pay agre Of the total planned reduction of 11,000 jobs about 3,500 were to be transferred to naval and offshore work at the yards.

(ii) The eventual closure of Robb Caledon Dundee, which forms of the contraction programme and some 200+ further redu to come from Govan, will reduce merchant shipbuilding em ment to below 16,800.

(iii) The estimated merchant shipbuilding employment at the m mixed yards at end June 1980 was Cammell Laird - nil; S Lithgow 1,600; Swan Hunter 1,800.

TABLE SHOWING EMPLOYMENT IN MERCHANT YARDS AND EMPLOYMENT IN MERCHANT SHIPBUILDING IN MIXED YARDS

	1 July 1977	mid-June 1979	End June 1980	Remarks
AN SHIPBUILDERS	5,662	5,446	3,020	Scotstoun yard (care and maintenance)
L LITHGOW & CALEDONIAN	5,200	3,601	260*	Cartsdyke - closed
INERY (PORT GLASGOW)				
L SCOTT'S SHIPBUILDING			1,331*	
L FERGUSON BROS	363	441	276*	
L SCOTT & SONS(BOWLING)	203	226	–	Closed
SA	456	515	375*	
BB CALEDON DUNDEE	1,015	1,101	597*	
BB CALEDON LEITH	592	628	532*	
THS DOCK	3,718	2,710	1,525*	Haverton Hill - closed
DERLAND SHIPBUILDERS	4,614	4,148	3,680	North Sands (care and maintenance)
STIN & PICKERSGILL	2,906	2,988	2,713	
AN HUNTER	7,275	2,093	1,802*	Walker yard (care and maintenance)
OLE	401	444	325*	
MELL LAIRD	4,340	2,714	–	All non-merchant
PLEDORE	870	893	670*	
ELANDS	505	–	150*	
LL RUSSELL	470	–	–	All non-merchant
TOTAL	38,590	27,948	17,236	

Note. The figures for merchant shipbuilding marked with an asterisk at end-June differ from the yard totals in Annex A because the latter include employment on other activities at the yards concerned (eg, naval, offshore shiprepair, non-shipbuilding activities).

EMPLOYMENT IN BS MERCHANT AND MIXED YARDS AND UNEMPLOYMENT RATES IN CORRESPONDING TTWAs AT AUGUST 1980 (PROV)

COMPANY	EMPLOYMENT	TRAVEL TO WORK AREA	PERCENTAGE UNEMPLOYMENT RATES TOTAL	MALE	SHIPBUILDING PER COMPANY AS PERCENTAGE OF WORKING POPU[LATION]
GOVAN SHIPBUILDERS	3241	GLASGOW	12.4	14.8	0.5
S L LITHGOW & CALEDONIAN* JOINERY (PORT GLASGOW)	2143	GREENOCK	14.3	15.3	4.2
S L SCOTT'S SHIPBUILDING*	2444	"	14.3	15.3	4.8
S L FERGUSON BROS	396	"	14.3	15.3	0.8
S L SCOTT & SONS (BOWLING)	1	"	14.3	15.3	-
AILSA	401	AYR	11.0	12.4	0.9
ROBB CALEDON DUNDEE	747	DUNDEE	11.8	12.7	0.8
ROBB CALEDON LEITH	555	EDINBURGH	7.4	8.9	0.2
SMITHS DOCK	2302	TEESIDE	13.4	14.4	1.0
SUNDERLAND SHIPBUILDERS	3680	WEARSIDE	15.2	17.3	2.6
AUSTIN AND PICKERSGILL	2713	WEARSIDE	15.2	17.3	1.9
SWAN HUNTER*	9192	NORTH TYNE & S TYNE	11.4	13.0	2.0
GOOLE	384	GOOLE	9.4	9.5	3.0
CAMMELL LAIRD*	3473	BIRKENHEAD	14.3	15.4	2.2
APPLEDORE	849	BIDEFORD	8.1	8.9	7.1
TOTAL	32526				

* Indicates mixed merchant and naval shipbuilding yard.

All the Travel-To-Work-Areas (TTWAs) in which those yards are situated are Special Development Areas except Teeside which is a Development Area and Goole, Bideford and Edinburgh which are Intermediate Areas. (Edinburgh is scheduled to be downgraded to a non-Assisted Area on 1 August 1982.)

Ø Working Population = Estimates of Employees plus the Unemployed in mid-1977.

ANNEX II

BS's Preferred Strategy

In the light of the expected downturn on naval requirements and the constraints of a degressive policy on subsidies, BS are now prepared to accept that Scott Lithgow and Cammell Laird should not build merchant ships but that their future should lie in offshore and naval. They are also prepared to contemplate the closure of Smiths Dock.

2 They do not expect any substantial MoD orders for their major mixed yards apart from some Oberon refits for Scotts and possibly a fleet tanker for Cammell Laird. To fill the gap they are, therefore, planning to take orders for three semi-submersible rigs at Scott Lithgow, and one at Cammell Laird. Both yards would cease merchant shipbuilding apart from the need for a produce tanker if MoD's requirement for a second fleet oiler does not materialise in time. Merchant shipbuilding at Swan Hunter would be greatly increased.

3 On this basis, BS's forecast of merchant ship deliveries plus drill rigs is:

1980/81	1981/82	1982/83
320,000	407,000	381,000

Deliveries of merchant ships ex drill rigs is as follows:

1980/81	1981/82	1982/83
320,000	373,000	361,000

Within the totals for 1981/82 and 1982/83 are 10,000 tons for conversions which are not eligible for Intervention Fund support.

4 BS say that these forecasts are compatible with Intervention Fund support of £45 million after the expiry of the current tranche of £55 million. Although rig charter rates have improved this year and may well continue to do so, they believe that at present prices

they cannot get the orders for semi-submersible rigs without quoting at a loss of up to 12½% which implies loss financing of £25 million on four rigs spread over two to three years.

Disposals

5 BS also plan to dispose of their shiprepair activities at Falmouth, Tyne Shiprepair Group and Vosper Shiprepair. However, it is not yet clear whether BS's statutory duty to carry on shiprepair will prevent disposal to the extent planned. Falmouth and Tyne Shiprepair are expected to reach breakeven by the end of the year. Vosper Shiprepair is heavily loss making at present and if BS cannot sell it or find a way of satisfactorily restructuring it, they will close it. 1,080 jobs are at risk. BS also intend to sell all their general engineering facilities with the exception of the engineering works at Vickers Barrow, and all peripheral activities. BS are very uncertain about the timing and proceeds from disposal but their tentative estimate, at present, is £3½ million this year and £3½ million next.

Economy measures and viability

6 The new Chairman of BS has taken immediate action to cut extravagant administration at BS and will concentrate his Headquarters in Newcastle with a saving of £3 million per annum. He is confident that savings in overheads can also be realised at the operating companies. He has stated his belief that BS can achieve viability within 4 years with steady reduction of call on the Exchequer meantime and visible realistic progress within 2 years.

Productivity

7 Prior to the shipbuilding recession there was a good deal of evidence to show that the UK industry was appreciably less productive than its competitors. In assessing Intervention Fund cases, the Department of Industry has allowed up to a 4% improvement in cost to

allow for improving productivity and reductions in cost. In practice, this departmental allowance has been over generous. Because of the loss of morale in the industry, due to the contraction programme and the general underloading, productivity fell last year. However, BS now say that with the much improved position on order-books, productivity has begun recently to improve.

Financial Implications

8 Mr Atkinson was asked to examine all possible ways of reducing the forecast cash requirement this year of £185 million; to reduce next year's cash requirement to not more than £115 million, and to achieve either breakeven after Intervention Fund assistance or a loss not exceeding £25 million. He was asked to assume that the Intervention Fund would continue after the expiry of the present tranche of £55 million but that the rate and volume of Intervention Fund support would be reduced.

9 He has reported that the cash requirement this year is irreducible being largely determined by past losses, Intervention Fund Payments, and a rundown of instalments in excess of work in progress. Provision for future losses at March 1980 including £16 million relating to restructuring costs totalled £68 million, Intervention Fund payments this year will be around £40 million, and instalments in excess of work in progress are expected to fall from £151 million to £106 million as the naval shipbuilders and particularly Vosper rund down their balances. The run down of balances at the naval shipbuilders is expected to continue in 1981/82. BS also point to the effect of the steel strike and the delays in placing certain naval orders. As far as next year is concerned, the effect of this year's losses and Intervention Fund commitments coupled with the need for a greater capital investment programme precludes any very substantial improvement.

10 BS's forecasts on an outturn basis for cash is, therefore, as follows:

Cash requirements - £m at 1980 outturn prices

1980/81	1981/82
185	156

116

They have given no cash forecast for later years but agree with the Department's assessment that, on the assumption they reach breakeven or bet in 1982/83, a cash requirement of £80 million for 1982/83 would be reasonable. The forecast of £156 million takes no account of disposals and it is, therefore, suggested that it should be reduced to £150 million.

11 Expressed in 1980 survey prices, this gives the following comparison with the PES provision for Intervention Fund (part of Programme 4) and BS's finances (part of Programme 5).

	1980/81	1981/82	1982/83
PES Provision	104	82	38
BS's forecasts	161	130	70

The table combines the PES provision for Intervention Fund payments and PDC because from the aspect of financing BS they are interchangeable. An extension of the Intervention Fund beyond the £120 million approved last year would not add to public expenditure but would have the effect of financing BS through the Intervention Fund rather than by PDC. The financing costs set out above do not include any provision further closure costs. This point is discussed further in para 64 bel

12 The present loss forecasts of BS after Intervention Fund support are (in outturn prices):

	£m	
1980/81		1981/82
110		70

13 In addition to the financing of BS through the Intervention Fund and PDC, the Department also finances the statutory Shipbuilding Redundancy Payments Scheme (SRPS). The present PES provision is not adequate because redundancies in the current financial year have bee greater than expected but it has not been possible until now to estimate the outturn for the current year because of uncertainties about BS's response to the pressure on their external financial limi BS now envisage up to some 2,150 additional redundances in the short- term (assuming the complete closure of Vosper Shiprepair) though this is likely to be partially offset by a shortfall in the programme for 3,000 redundancies which formed part of the February 1980 pay agree- ment. It thus seems prudent to budget for an additional 1,000

redundancies under the current scheme. On this basis, the expenditure under the current scheme will be as follows:-

Latest Estimate (£m)	1980/81	1981/82	1982/83	1983/84
Outturn prices	31	11	3	0
PES 1980 prices	26	8.4	2	0
Current PES Bid				
PES 1980 prices	13	6	1	0

14 The foregoing estimates make no provision for redundancies arising from further major shipyard closures or cutbacks not already included in current plans. Such redundancies are unlikely to fall within the scope of the present scheme.

15 The average cost per redundancy after 1 April 1980 is running at £3,300 under the shipbuilding redundancy scheme. There is also an average benefit of £1,500 under the general redundancy provisions of the Employment Protection Act which is not included in the PES figures above but 59% of which is borne by BS and, therefore, funded by PDC. The shipbuilding redundancy payment scheme expires in June next year and the future of the scheme is discussed in paras 57-61.

BS's Main Assumptions

a) Capital Investment Programme

16 Capital investment is expected to rise from the current level of £18 million which is heavily depressed by the cash crisis to £38 million next year, of which half would be spent at the specialist naval shipbuilders. Capital investment has been too low at BS for a number of years now and £38 million is probably around the minimum to ensure a healthy industry.

b) Pay and Industrial Relations

17 BS are assuming that their pay settlement due on 1 April will not exceed 9%. They are also assuming good industrial relations although they say that there is a risk of Union opposition to their

disposal plans. BS this year have lost more man hours through st (principally through stoppages at the specialist naval yards) than 1978 and 1979 combined. Even so, the record of the industry is appreciably better than before nationalisation.

c) Prices and Exchange Rates

18 BS are assuming, in accordance with the Department's guidance, that sterling will remain strong. They are, however, assuming that owners will pay a 15% premium to build in Britain rather than in Japan, and that prices will harden sufficiently to allow the Japan a 15% profit in 1983 and to allow BS's prices to rise in line with inflation. UK owners commonly pay a premium to build in Britain b the maintenance of the current premium at 15% seems optimistic. T is also room for doubt as to whether ship prices will keep pace wi UK inflation.

d) Closure Costs

19 BS have assumed that they will bear all closure costs relatin to their restructuring programme but that all other closure/restru ing which may prove necessary would be borne outside the External Financial Limits for management purposes. This would include an restructuring, for example, at Vosper Shiprepair and the closure the Hartlepool works of George Clark under BS's plans for the restructuring of their engine facilities.

Departmental Assessment

20 In the Department's view, BS would do well to achieve their forecasts. There are two major considerations. First, now that yards have for the most part got satisfactory orderbooks morale a productivity should improve unless Ministers decide on further cu backs in capacity. The new Chairman who is an experienced indust ist may also provide the industrial leadership combined with fin discipline which BS need. The speed with which he has acted in introducing economies is encouraging. On the other hand, one or t of the major BS's assumptions appear a little optimistic and BS's detailed forecasts are based on individual yards who have a histo of excessive optimism and poor financial forecasting. The closure Smiths Dock and the removal of both Scott Lithgow and Cammell Laird would reduce the risk.

BACKGROUND INFORMATION ON THE MARKET FOR MOBILE OFFSHORE INSTALLATIONS

1 The United Kingdom share of work on the UK Continental Shelf has now risen to about 80%. But performance in those areas of marine activity requiring heavy capital investment, such as drilling rigs, accommodation barges, deep diving support vessels, heavy lift and pipe laying barges, has been poor. This weakness lies in both the lack of investment confidence and an established capability to undertake these tasks and a poor track record in building such vessels.

2 The demand for capital equipment of this sort is vulnerable to changes in political climate and licencing policy, advances in technology and to oil price movements. In the past equipment ordered on a rising market has sometimes become available as demand has slackened. This has been true of the activity on the UK Continental Shelf as elsewhere.

3 A number of factors point to a more stable market demand at least in the vicinity of the UK for the foreseeable future. The British Government now holds more frequent, although smaller, licencing rounds; there is an increasing trend to undertake pre-development drilling and drilling of further wells on established fields to improve reservoir depletion; and as new fields will be smaller than those already discovered increased exploration will be required to sustain reserves. This all means more rigs. Furthermore, looking to the longer term, there is also likely to be demand for floating production facilities, especially for the development of the smaller fields and for support and accommodation vessels. All of these structures are likely to be based on a semi-submersible hull, although the production facilities offer additionally the prospect of work in a new area of high technology.

4 With development of the UK Continental Shelf entering another phase a number of oil rig operating companies are showing an interest in expanding the UK drilling capability. The question is whether they will order in the UK.

5 British shipbuilders missed out entirely in the boom in semi-submersible structures of the early 1970s but have in recent years shown some awareness of the need to get into the market. They have so

far been awarded one order, for a £60m semi-submersible emergency support vessel (ESV) for BP. This was placed in 1978 with Scott Lithgow, but no foreign bids were included in the tenders, BP def ing part of the cost to themselves through BNOC taking a 25% stake the equity. BP appear to be well satisfied with progress on the vessel although it is a little behind its original schedule.

6 In 1979 British Shipbuilders and Harland and Wolff tendered a semi-submersible multi-purpose support vessel (MSV) for Shell. However, these two yards were unable to match bids from foreign ya either on price (£70m as against around £40m) or delivery dates (years compared to 2 years), and the order went to the Finnish yar Ruama Repola. (Recent press reports have suggested that the Finni sub-contractors deliberately underbid Ruana Repola and that delays and cost increases are now being incurred. It is true that there have been delays and cost increases but Shell and the classificati society have called for design changes which would have applied equally to a UK builder and which entirely explain these.)

7 British Shipbuilders are currently dealing with a number of enquiries of which the most definite (2 from Scott Lithgow and 1 fr Cammell Laird) relate to tenders being considered by BP for a new semi-submersible drilling rig. Some of the enquiries are shown in the table appended.

8 It is clear that many potential customers would like to have installations built in the UK, even at a premium. An overseas con- struction, although cheaper, incurs some significant overhead cost towage, loss of revenue and high interest charges during tow, and monitoring construction in a foreign yard. The opportunities for British Shipbuilders to use their facilities and become an establi and competitive capability to build mobile offshore installations are thus considerable. And the market should last.

9 The market, though, is international and fiercely competitiv British Shipbuilders have no proven track record yet with which t win the confidence of the oil companies and establish their credi ity in this field. They will need to assure the oil companies th they understand the market and can compete with foreign yards bot price and delivery. A marked increase in productivity will play

important part in this: present man-hour assumptions by British shipbuilders seem to be more than twice that of continental competi- tors and British Shipbuilders would have to show that they are embark- ing on a sustained programme to bring their productivity up to scratch if oil company confidence is to be secured.

10 If British Shipbuilders win orders by specifically quoting below cost they will need to take into account the effects on their prospects of securing follow-on business other than at a loss. It would seem unwise therefore to allow British Shipbuilders to follow this course unless either they can demonstrate they have a programme for improving productivity to the point where they can get business without loss, or Ministers are prepared to sanction further loss financing of such orders.

Offshore Supplies Office
Department of Energy

11 September 1980

Company	Vessel Type	Yard
Atlantic Drilling (Ben Line)	Drilling, eg Western Pacesetter (for BP charter bid)	Scott Lithgow
Consafe	Accommodation – Western Pacesetter hull Drilling (2) – Western Pacesetter	Scott Lithgow Scott Lithgow
Davy (for major oil company)	Floating production facility	not settled
Houlder Offshore	Drilling, eg Western Pacesetter (for BP charter bid)	Scott Lithgow
KCA	Drilling – Aker H-3.2 (for BP charter bid) Drilling – Aker H-3.2	Cammell Laird Cammell Laird
Narby and Associates	Drilling – rig not defined	not settled
Occidental (through Sedco-Hamilton)	Floating Production facility	combination
Seaforth/Wharton Williams	MSV (Thor Haavie design)	Cammell Laird
Sedco	Drilling – Sedco 700 series (for BP charter bid)	not settled
W Wilhelmsen	Accommodation on Western Pacesetter hull	Scott Lithgow
Consafe	Accommodation Jack-up	Cammell Laird
Zapata	Drilling Jack-up	Scott Lithgow

Source: Market Review of Mobile Offshore Platforms
British Shipbuilders, June 1980

SHIPBUILDING REDUNDANCY PAYMENTS SCHEME

PRESENT SCHEME

1 In addition to the financing of BS through the Intervention Fund and PDC, the Department also finances the statutory Shipbuilding Redundancy Payments Scheme (SRPS). The present PES provision is not adequate because redundancies in the current financial year have been greater than expected but it has not been possible until now to estimate the outturn for the current year because of uncertainties about BS's response to the pressure on their external financial limit. BS now envisage up to some 2,150 additional redundancies in the short term (assuming the complete closure of Vosper Shiprepair) though this is likely to be partially offset by a shortfall in the programme for 3,000 redundancies which formed part of the February 1980 pay agreement. It thus seems prudent to budget for an additional 1,000 redundancies under the current scheme. On this basis the expenditure under the current scheme will be as follows:-

Latest Estimate (£m)	1980/81	1981/82	1982/83	1983/8
Outturn prices	31	11	3	0
PES 80 prices	26	8.4	2	0
Existing PES provision				
PES 80 prices	13	6	1	0

2 The foregoing estimates make no provision for redundancies arising from further major shipyard closures or cutbacks not already included in current plans. Such redundancies are unlikely to fall within the scope of the present scheme. (See below.)

FUTURE OF THE SRPS

3 The legislative powers for the current SRPS for Great Britain and the identical Northern Ireland scheme expire on 1 July 1981. The effective date of expiry is much earlier than this - at the beginning of April 1981 - because advance notice of redundancies has to be given under the Employment Protection Consolidation Act.

4 BS are facing a degressive policy on subsidies and are already contemplating the closure of Smiths Dock. In addition they will restructure shiprepair if they cannot sell it. MOD are reducing requirements for surface ships. The question arises whether the Government should take fresh powers to renew the SRPS for a further period or whether it should provide additional finance to enable BS to top up the general redundancy payments benefits. Given the present uncertainties expenditure has been calculated per 10,000 further redundancies at an average cost of £3,500 per redundancy at 1980 prices.* On the assumption that the majority of the redundancies would fall in the financial year 1982/83 the phasing of the expenditure would be:-

(£m)	1981/82	1982/83	1983/84	1984/
Outturn at 1980 prices	8	17	8	2
1980 survey prices	6.7	15.7	8.1	2.

* The average cost of £3,500 at 1980 prices is based on the curr average of £3,300 plus a contingency margin to allow for increasing certain benefits fixed in cash terms should that prove necessary at some future stage.

5 The main considerations are:-

(i) an extension of the SRPS would signal that the Government are envisaging a further major contraction of the industry. This would enable opposition to any further closure in the shipbuilding industry to be concentrated well in advance;

(ii) an extension of the SRPS would tend to make it look a permanent scheme and make eventual termination more difficult;

(iii) any statutory scheme is inflexible and cannot easily be adapted to deal adequately with the variety of circumstances in the industry. The existing scheme has been expensive on Parliamentary (and official) time by way of amending orders which the Opposition use to debate the shipbuilding industry as a whole;

(iv) on the other hand if the statutory scheme is ended BS will come under heavy pressure to make equivalent payments to redundant shipyard workers. Failure to make such payments, the cost of which would have to be met by the Government, would compromise the success of any further restructuring plan. Considerable sums of money are at stake. An additional 10,000 redundancies would cost £35m at 1980 prices. So long as control of the scheme remains in Departmental hands, union pressure to have the scheme benefits increased is resisted more easily;

(v) the Chairman of BS has pressed strongly for the scheme to be continued on the grounds that it will be helpful to him in working towards viability.

6 The prolongation of the SRPS is accordingly strongly recommended. Powers will need to be taken during the forthcoming session and it is proposed to include a short uncontroversial

clause in the Industry (No 2) Bill.

5 A two year prolongation is recommended as this is the mi period required to cover redundancies arising from further clos (unless work on existing orders is abandoned) in the light of constraints set out in BS's review. A further decision on the of the SRPS will then be required in mid-1982.