

PO-CH/NL/0187

PART B

Alex  
Lawson

PART B

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PO -CH /NL/0187



PART B

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CHANCELLOR'S 1988 PAPERS  
ON THE SHIPBUILDING  
INDUSTRY

PO -CH /NL/0187  
PART B

Begins: 02/3/88

Ends: 29/4/88 (CONTINUED)

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PPS, P1  
PWP

CHANCELLOR

FROM: FINANCIAL SECRETARY

DATE: 22 March 1988

**SHIPPING PAYE AND TAXATION OF SEA FARERS**

I have discussed with officials Mr Lewis' note of 9 March which set out a number of options designed to encourage UK shipping companies to continue to employ UK staff and thereby to reduce the risk of tax-induced "re-flagging".

2. Of the alternatives, two essentially involve changing the residence rules (so as to make more merchant seamen non-resident for tax) or altering the conditions for the 100% relief for long absences overseas (so as to bring more resident seamen into its scope).

3. There are however a number of problems with this approach:

- The residence rules are at present under review and we are due to put out a consultative document later in the year proposing changes to these rules (my note to you 18 February). As you know, the present rules are fairly complex and are based more on case law than statute law. Any piecemeal change made now for seamen would be difficult to reconcile with the more fundamental changes we might want to make after the review.

- Colleagues of course are not aware of this but it must be a significant consideration in our minds. In both cases the tax liability depends on the number of days absence from the UK. While relaxing the rules would result in more people being exempted there is no guarantee that the right people would always benefit.

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- In both cases you can only be sure of relief after the event - after you have spent the necessary days abroad. So, for the people we want to help, there would be no guarantee that relief would be due.

- There would undeniably be pressure from others who also work overseas for long periods (eg. airline crews, construction workers) for similar relief.

4. An alternative would be to introduce a special exemption for merchant seamen. But this would be both very generous and very difficult to justify in principle especially after a Budget which has removed several tax shelters and cut tax rates. In addition, there would be considerable difficulties in framing a suitable definition and deciding how to treat borderline cases (eg. should an exemption cover deep-sea fishermen?)

5. One other possibility, which on the face of it seems less troublesome would be to exempt the shipping companies from operating PAYE. They have threatened to go further offshore if challenged on PAYE, but it is difficult to see what they really gain through non-operation of PAYE. This would leave the individual seamen liable to pay their own tax - in practice only very little tax would be likely to be collected as the Revenue would have no details of the people concerned - but at a significant administrative cost. Moreover, as some companies have already indicated that they would not fight a decision to operate PAYE there does not seem to be much reason to let them off the hook creating a precedent which other employers would not be slow to try to follow.

6. I am sceptical about whether this is a problem that can be solved through changes to the present tax system, and you may like to discuss.

7. In the meantime I have suggested to officials that the PAYE paper attached to Mr Lewis' note should be sharpened up to focus on the consequences of enforcing PAYE and to look at the alternative option of exempting shipping companies from operating PAYE.

*Norman Lamont*  
77  
NORMAN LAMONT



MINISTER  
FOR PUBLIC TRANSPORT

DEPARTMENT OF TRANSPORT  
2 MARSHAM STREET LONDON SW1P 3EB  
01-212 3434

PWP

My ref:  
Your ref:

25/3

CH/EXCHEQUER	
REC.	25 MAR 1988
ACTION	<del>EST</del>
COPIES TO	

Jonathan Taylor Esq  
Private Secretary to  
the Chancellor of the Exchequer  
HM Treasury  
Parliament Street  
LONDON  
SW1P 3AG

23rd March 1988

Dear Jonathan,

**MERCHANT SHIPPING BILL: COMMITTEE STAGE**

In my letter to you of 17th February I promised that I would let you know of any points made during Committee about taxation issues.

I enclose a point made by Mr Barry Field during the Fourth Sitting, on Tuesday 23rd February 1988, asking if the bounty proposed by the Bill would be tax-free. Column 123 of the Committee Hansard Report refers - the relevant clause is Clause 27 of the Bill.

You may also be interested to note that there was some interest expressed on the imposition by the EEC of VAT on travel fares. Please refer to Column 190 of the Sixth Sitting Report of Tuesday 1st March 1988.

Yours sincerely,

J Thatcher

JILL THATCHER  
Private Secretary

**Mr. Hughes:** The hon. Gentleman makes an interesting point. If clause 37 gives the Minister the power to intervene in connection with vessels in the North sea, I shall be happy to take part in a debate on cabotage under new clause 1.

**Sir David Price:** The hon. Member for Aberdeen, North, with his usual perspicacity in reading drafts, will know that new clause 1 goes wider than clause 37 and deserves separate debate. The North sea matters raised by the hon. Gentleman are separate from that of cabotage in relation to our membership of the European Community and the Single European Act, which comes into force in 1992. I hope that the Committee agrees that it would be more convenient if we deferred debate on the issue until we come to new clause 1.

**Mr. Mitchell:** My hon. Friend the Member for Eastleigh (Sir David Price) referred to the problems of cabotage. As he said, a new clause on the subject has been tabled and we should concentrate our debate on the issue when we debate it. I shall be happy to discuss with him then what can and cannot be done.

I listened carefully to the hon. Member for Aberdeen, North (Mr. Hughes). I understand his desire to ensure that our powers to take action to safeguard our shipping and trading interests are not unnecessarily restricted.

Clause 37 will give the Secretary of State wide powers to regulate the admission and departure of ships to and from United Kingdom ports, to regulate the nature of the services those ships may be used to provide, the loading or unloading of cargoes, the embarkation or disembarkation of passengers or the doing of anything else in connection with the provision of any shipping services. In addition, he may regulate the provision of any shipping services, and the making and implementation of agreements whose subject matter relates directly or indirectly to that provision. These powers are not limited to international shipping services: they could be invoked against ships operating in United Kingdom cabotage trades, or the service of our offshore installations. I give the hon. Gentleman that assurance. The hon. Gentleman was not strictly correct when he said that it was impossible for United Kingdom offshore vessels to operate in Norway. They occasionally do so, but not as frequently as I or the hon. Gentleman would like.

I went to Norway to talk with my opposite number there about the ability of British ships to get contracts and we identified several causes, which were not necessarily a sign of discrimination by the Norwegian authorities. For example, a British offshore vessel would require a pilot; a Norwegian one would not. That would mean that the Norwegian vessel would be able to put to sea immediately it was signalled that it was required to service an offshore installation; perhaps during a lull in the weather. A United Kingdom vessel would have to wait for a pilot. We secured a considerable concession from the Norwegian authorities on that issue and they agreed to try to ensure that there was fairer competition.

No Minister would contemplate using these powers lightly or without giving full consideration to the possible consequences. However, if he were faced with

that prospect, I believe that clause 37 already gives him sufficient powers to take measures in defence of United Kingdom shipping or trading interests where these are threatened by the actions of a foreign Government or their agents. I hope that, in the light of my explanation, the hon. Gentleman will feel able to withdraw the amendment.

**Mr. Hughes:** I may not be as optimistic as the Minister about trading and oil exploration and production in the North sea, but I accept his assurance that clause 37 will allow him to act should he so wish. I beg to ask leave to withdraw the amendment.

*Amendment, by leave, withdrawn.*

*Question proposed, That the clause stand part of the Bill.*

**Mr. Hughes:** I have one innocent and simple query on clause 37. Proposed subsection (3)(e) states:

"imposing, in pursuance of any Community obligation, such tax or duty payable by such persons and in such circumstances as the Secretary of State may specify".

Will the Minister confirm that that is a paving amendment which will allow him to concede the imposition by the EEC of VAT on travel fares?

**Mr. Mitchell:** The hon. Gentleman will be pleased, if not satisfied, that the answer is no.

**Mr. Hughes:** We may discover when we return to that comment—an innocent reply to an innocent question—that the Minister has been economical with the truth.

*Question put and agreed to.*

*Clause 37 ordered to stand part of the Bill.*

*Clause 38 ordered to stand part of the Bill.*

### Clause 39

#### BORROWING POWERS IN CONNECTION WITH LIGHTHOUSE EXPENDITURE

*Amendments made:* No. 71, in page 38, line 30, leave out from beginning to end of line 8 on page 39.

No. 72, in page 39, line 12, leave out "of a capital nature".

No. 73, in page 39, line 24, leave out from beginning to "the" in line 26.

No. 74, in page 39, line 36, after "(1)", insert

"The Secretary of State with the consent of".

No. 75, in page 39, line 37, leave out "they think" and insert "he thinks".

No. 76, in page 39, line 40, leave out

"the Secretary of State under section 662(2)"

and insert

"a general lighthouse authority under section 662A".

[Sir. David Price.]

regard those ships as beyond the immediate reach of any British Government in an emergency rather than a war. The Committee must consider that point.

I should probably wonder beyond the scope of the clause if spoke further about the sort of schemes that are slightly different to the American mothballing and slightly different to those proposed in 1939. Such a system would make sense. We would have more ships available in times of emergency. There is little doubt that the Ministry of Defence is optimistic about the availability of ships. It is much more convenient for it to be so. If the Ministry of Defence took a more pessimistic view, that would have expenditure consequences. Naturally, the Ministry is not keen to face up to those consequences when it is strapped for cash.

**Mr. Mitchell:** To debate the availability of ships when considering a clause on the availability of crew would make me out of order.

**Mr. Robert Hughes:** Not at all.

**Mr. Mitchell:** We are debating a proposal that there should be a reserve for Merchant seamen.

**Mr. Robert Hughes:** I was shaking my head to say that it is not for the Minister to decide what is or what is not in order. He should try to answer his hon. Friend the Member for Eastleigh (Sir D. Price). If the Minister strays out of order, I am sure that you will put him up, Mr. Rhodes James.

**Mr. Barry Field:** Can hon. Friend the Minister confirm that the bounty that he proposes will be tax free in the same way that it is for the Territorial services?

**Mr. Mitchell:** That is a matter for my right hon. Friend the Chancellor and I am not aware of his views at the moment. I am sure that we shall have the opportunity to discuss the matter later.

My hon. Friend the Member for Isle of Wight asked whether there were enough merchant ships for our defence needs. I assure the Committee that, even taking into account the decline of the fleet, we have sufficient ships to support any likely British operation overseas.

**Mr. Tony Lloyd:** That is crucial to the debate. We may have sufficient support vessels for military activities, but we are an island. The problem in the second world war was not simply the supply of the military; it was the supply of the nation's normal trading needs. Despite worries to the contrary, the Government say that we have the merchant fleet for both those tasks.

**Mr. Mitchell:** The hon. Gentleman is extending the point raised by my hon. Friend the Member for Isle of Wight about the adequacy of the supply of merchant vessels for defence. The hon. Gentleman asks a wider question — quite legitimately — about the ships needed for reinforcement and civil supply. They are

subject to a pooling arrangement with our NATO partners. A study of the adequacy of the merchant shipping available to NATO countries is in hand. I do not wish to prejudge the outcome.

**Sir. David Price:** With respect, I quoted figures from the Second Reading debate which throw grave doubt on the NATO position. The hon. Member for Stretford (Mr. Lloyd) is right. The roles are to transport reinforcements to the British Army on the Rhine and to support the civil population. There is a third role to bring American troops to Europe on a NATO pooling basis. Grave doubts have been expressed about that. Other countries find themselves in a similar position, although not one as dramatic. The total tonnage of their merchant navies has been reduced. However, not only the total tonnage but the mix of the fleet is important.

**Mr. Mitchell:** My hon. Friend has expertise in this matter. He is right to say that it is a matter not simply of the overall tonnage but of the mix of the fleet. There may be more difficulty in some special areas than in others. A study is in hand and it would be wrong for me to prejudge the answer.

My hon. Friend the Member for Ludlow suggests a strategic reserve of ships. Even second-hand ships are a costly asset to lay up. A second-hand ro-ro vessel might cost as much as £15 million. To buy a year-old bulk freighter would cost about £3 million. On top of the purchase costs would come the cost of refit and maintenance costs. As my hon. Friend the Member for Isle of Wight said, United States experience suggests that that would be expensive. There is a misprint in my notes, so I shall advise the Committee later on the costs per vessel kept in a state of prompt availability. Any attempt to reduce maintenance would greatly increase the delay before a vessel could be made ready for active use. Even with regular maintenance, the ship would become progressively obsolete with consequential difficulties in such matters as the supply of spares.

**Mr. Gill:** My concern was about people rather than ships. I said that people would not be attracted unless there were ships in which they could serve or train. The logic of the case seems to be flawed because merchant ships that we could requisition are now crewed by foreign nationals not by people normally resident in the United Kingdom. But where will the reserves come from in the first place? It does not seem possible to create a reserve from longshoremen — they have no previous experience of deep sea sailing.

**Mr. Mitchell:** To qualify for the Reserve, they would have to have had that experience. They will not be actively engaged in the merchant fleet at the time. They will have been in the merchant fleet and now are shore based. There are many such people who, because of the contraction of the fleet, have had to seek employment elsewhere.

**Mr. Gill:** Will my hon. Friend concede that the people's experience will be out of date or that the process will be rather long in the tooth? We have already



~~MD to call back.~~

~~BF 25/3~~

Note

Told R/CST & FST they go to E(A).

Told M'Donnelly spk to

SEF. But try Bank first.



*Center has handwritten. Has Mr King approved BGS?*

FROM: A M WHITE  
DATE: 24 MARCH 1988

*Ch/ This, it seems, is what Mr King*

PS/CHANCELLOR

*wanted a word about.*

cc PS/Chief Secretary  
Miss Peirson  
Mrs Brown  
Mr Waller

*Might be raised at shipbuilding on Thurs, but more likely at mystery meeting of E(A) for which, as yet, no agenda circulated. For CST to deal now, and at E(A)?*

*mgnw 24/3*

**JAMES MACKIE BELFAST, PROPOSED ACQUISITION BY SECRETARY OF STATE FOR NORTHERN IRELAND**

The Secretary of State will shortly be circulating proposals to colleagues seeking agreement to provide assistance to this company on social grounds. The proposals amount to taking the company into public ownership with uncertain prospects of returning it to the public sector in the medium term. We have opposed them at official level.

*(E(A))*

Background

2. The engineering industry in Belfast is in poor shape. You are aware of the position on Harland and Wolff and the extreme difficulties that Shorts, the other large Belfast firm, faces. James Mackie, a textile engineering company, is the largest employer in West Belfast and is in very poor shape.

3. The Mackie family severed their links with the company in 1977, transferring ownership to a trust whose beneficial members are the past and present workforce. At that time funds owed to the Mackie family were replaced by bank overdraft facilities.

4. Efforts to find a private sector 'White Knight' to sustain the company in the private sector have failed and the Secretary of State now feels that he must either acquire the company and pump funds in to sustain its operations while it is modernised and re-equipped or accept the closure of the business by its creditor banks and the trustees acting in the best interest of the beneficiaries.

*They are to be @ original (as much) private sector. Leher would be L. A. L. A. L. A. L.*

5. The Secretary of State would be most reluctant to see the closure of the last significant manufacturing employer in Catholic West Belfast with the loss of 1000 jobs in that area of extremely high unemployment, social deprivation and alienation.

6. Consequently he is likely to propose the immediate acquisition of the company by his Industrial Development Board on social grounds, with the intention of investing some £20m in restructuring and modernisation with a view to restoring the company to viability and subsequent sale to the private sector.

7. But even if the restructuring were to be carried through successfully, and the IDB's track record gives little grounds for optimism on that, merchant bank advice is that a sale to the private sector in some five years time would yield no more than £6m at best.

8. In discussion this week at official level we have made clear our opposition to the proposal but it is certain that given the political consequences that Mr King sees as flowing from a closure decision he is now likely to bring the matter forward to colleagues.

9. This note is by way of advance warning and, as it is possible that Mr King will raise the issue in the context of the meeting on shipbuilding on 31 March, we will prepare a short contingent brief on Mackies that the Chancellor could draw on in that discussion. We shall of course provide full briefing on Mackies once the Secretary of State has circulated his proposals.



A M WHITE

BF 30/3



## Inland Revenue

Policy Division  
Somerset House

FROM: P LEWIS

DATE: 25 MARCH 1988

Ch.  
Chancellor

Content with something  
along these lines?  
25/3

[I have spoken  
to the FS  
He will discuss a  
new 1% rule for 11.4.88  
now.]

## SHIPPING

1. I understand that in the course of your discussion with the Financial Secretary yesterday afternoon you asked if the drafts attached to my note of 9 March could be recast to discuss the tax options and to reach generally discouraging conclusions about them.

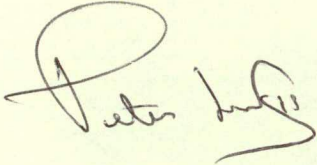
2. I attach a revised draft which brings the two previous notes together and is, I hope, more along the lines you would like.

3. The final section discusses relaxations of the residence rules and the rules for the 100% foreign earnings deduction. We have found it difficult to see how any relaxations on residence could be of much real help here. But if you wished to leave that possibility open for further consideration at this stage - it was, I understand, about the only thing you were inclined not to rule out yesterday - we could leave this part of the note a bit more open.

cc Chief Secretary  
Financial Secretary  
Paymaster General  
Economic Secretary  
Sir P Middleton  
Mr Scholar  
Mrs Case  
Mr Revolta  
Miss Sinclair  
Mr A R Williams  
Mr Cropper  
Mr Tyrie  
Mr Call

Chairman  
Mr Isaac  
Mr Painter  
Mr McGivern  
Mr Lewis  
Miss Rhodes  
Mr Fraser  
Mr I Stewart  
Mr K Allen  
PS/IR

4. Transport officials have called a meeting for next Tuesday to discuss the handling of these papers, including a draft submission from the Secretary of State for Transport which is intended to draw the issues together. We will report on the outcome. We have noted that you will want to put your own paper in separately.

A handwritten signature in cursive script, appearing to read "Peter Lewis". The signature is written in dark ink and is positioned to the left of the typed name below.

P LEWIS

TAXATION OF SEAFARERS

Note by the Chancellor of the Exchequer

1. At our meeting on 23 February I was asked for papers on the PAYE/Isle of Man problem and on the personal taxation of seafarers.

2. This note looks at the present position, and possible changes to assist with crewing costs. My conclusion is that tax changes <sup>won't be</sup> offer <sup>a</sup> ~~no~~ <sup>serious</sup> solution to the problem of uncompetitive British crewing costs on ships which we wish to retain on the British register for defence reasons.

PAYE and the Isle of Man agencies

3. Until a few years ago, most shipping companies employed their crews directly and operated PAYE like other UK employers. Over the last few years many have stopped employing the crews on their ships and instead engaged them through overseas agencies. The crew then have their contracts of employment with the agencies and are paid by them. The shipping companies are not operating PAYE for crews engaged in this way.

4. The point at issue between the Revenue and the shipping companies is whether they are still required to operate PAYE when they engage their crews through offshore agencies. The law makes special provision for circumstances in which an employee of one person works for another. Where that second person has "general control and management" of the work done, he is liable to operate PAYE, even though the worker concerned is not his own employee and is not paid by him.

5. So the question the Inland Revenue have been considering is whether the shipping companies have the "general control and management" of the work done by the crews of their ships. The circumstances vary in detail, and, of course, the Revenue have not yet obtained information on every case. But the general picture emerging is that the shipping companies do have the

control and management of the work of the crews on their ships, and the Revenue's legal advice is that the shipping companies should be operating PAYE.

6. Because of our discussions, the Revenue have not yet given their views to the shipping companies. The shipping companies would, of course, have an opportunity to persuade the Revenue that their views are mistaken, initially through discussions and, if they wished, through appeals to the Appeal Commissioners and, ultimately, to the Courts.

7. The question of whether or not the shipping companies should be operating PAYE ought not to be a big issue for them. PAYE is an administrative arrangement for collecting the crew's UK income tax liability. It does not affect the amount of the tax for which they are liable, and the tax paid to the Revenue is not an additional cost for the shipping company. There are, of course, some administrative costs; but the system has been much simplified recently, and the cash flow benefits of retaining the tax before paying it over to the Revenue mean that there is often little or no financial cost for the employer.

8. While the operation of PAYE should thus be a matter of relative indifference to the shipping companies, it is important for the Revenue. Deduction at source is self-evidently a more efficient and effective way of collecting tax than looking to each individual seaman to settle his own tax liability. And the Revenue cannot collect the liability directly from the seamen if the shipping companies ought to be operating PAYE. In any event, the Revenue has to apply the law to the shipping companies in the same way as it is applied to all other employers.

9. I can see no conceivable basis on which I would be justified in picking out shipping companies for a special exemption from PAYE obligations. Everyone would know that that would be little help to them, unless the assumption was that they would be able to negotiate lower wages on the footing that their crews would,

in one way or another, avoid paying any UK income tax on their pay. We would thus implicitly be encouraging and condoning that situation. In any event, it would make no sense to maintain the tax charge on UK seamen while depriving the Revenue of the administrative arrangements necessary for collecting the liability. And since PAYE is simply a collection mechanism, it would be impossible to justify exempting shipping companies from its requirements and not others in similar situations. Even if we abandoned PAYE and the seamen thus achieved a de facto exemption, that might not be sufficient, particularly in the longer term, to bridge the gap between UK wage levels and those of competent third world crews.

10. But while I believe the PAYE position must be maintained, I recognise that starting tax deductions again could in certain circumstances increase the shipping companies difficulties. The fact of the matter is that some seafarers - perhaps the majority of those concerned - have recently been receiving their earnings tax free. To the extent that shipping companies have already negotiated wage rates on this basis which are lower than they would otherwise have been, starting PAYE again would put upward pressure on pay costs. I have, therefore, considered whether there is any solution in reducing the tax liabilities of UK seafarers.

#### Taxation of seafarers

11. The taxation of seafarers, like other people, turns mainly on two considerations

- whether the seafarer is resident in the UK for tax purposes
- whether he performs his duties in the United Kingdom or overseas.

A non-resident seaman is only liable for tax on earnings in the United Kingdom. But if the seafarer is resident in the UK - and most UK seamen will be because they have their homes here and

spend a fair amount of time in this country - he will be liable to UK tax on all his earnings, whether the duties are performed in the UK or overseas.

12. There is, however, a special tax relief which, although it was not introduced with seamen in mind, can provide a substantial benefit for UK resident seamen who work overseas for long periods. The 100% foreign earnings deduction is given where a seaman spends a period of 365 or more days overseas with not more than 62 consecutive days in the UK.

13. Because of the diverse and quickly changing pattern of shipping - and the cessation of PAYE in many cases - the Revenue do not have a clear picture of the aggregate tax liabilities of UK seamen employed in the deep sea trades which are most exposed to foreign competition. The GCBS have recently quoted a figure of £70m for the tax liabilities of British seamen on UK registered ships. Of those employed in the deep sea trades, some will be exempt because they are non-resident and some - possibly an increasing number because the shipping companies are said to be planning seamen's work in that way - will qualify for the 100% foreign earnings deduction. But under the present rules it is probably the case that at least as many are due to pay tax in the UK as are exempt.

#### Possible changes

14. I have considered two possible ways in which the liabilities of seafarers might be reduced with a view to reducing, indirectly, the crew costs of British ships - an exemption for particular classes of seafarers, or an extension of the present reliefs for people working predominantly abroad, either through the residence rules or the 100% foreign earnings deduction.

#### An exemption for seamen

15. This looks extremely unattractive as a matter of tax policy.



16. We would need to define the particular types of seamen - or rather particular types of voyage whose earnings would be exempt. There is clearly no point in exempting people - such as seamen on ferries - for whom there is no defence problem.

17. Such an exemption would be unique. It could not be justified on the grounds that a seafarer's taxable capacity was less than that of someone else with the same income. It would thus be considered unfair, both by those seamen who did not qualify (and whose importance in defence terms might be just as great) and by other taxpayers generally. It would lie very awkwardly with the taxation of Royal Naval personnel, who are chargeable on all their pay however long they serve abroad.

18. It would also be clearly contrary to the general thrust of ~~my~~ tax policy which has been to reduce tax rates while broadening the tax base by removing or restricting special exemptions and reliefs wherever possible. DWR

19. Nor, in any event, do I think this would be effective in tackling the problem of crew costs.

- some of the relief would inevitably go to UK seamen serving on foreign-registered ships which might not be available, or available only to a limited extent, to the UK in an emergency
- of the relief going to the ships we wish to help, almost certainly the full cost of the tax relief would not be reflected in reduced crewing costs because that would be a matter of negotiation between ship owners and seamen. (The GCBS have pointed to the amount of income tax seamen pay, but they have not argued for an exemption as such apparently because they recognise that some mechanism would be needed to ensure that the benefit accrued to the shipping companies if it were to be of any help in reducing their costs. They have not suggested any such mechanism)

- you cannot easily vary the amount of a tax exemption to give the amount of assistance required; and as tax rates fall an exemption becomes less valuable (as the charities are always telling us).

20. My conclusion is that a tax exemption for seamen would be ~~highly~~ unattractive <sup>low</sup> and would be ~~very~~ inefficient as a method of assisting shipping companies with crewing costs. not over

#### Residence rules and the 100% foreign earnings deduction

21. The argument for easing these rules would be that more seamen would benefit from them and their increased net pay would enable the shipping companies to pay lower wages.

22. In terms of tax policy and general effectiveness this approach seems to suffer from much the same disadvantages as a special exemption. It would in fact represent a reversal of previous policy, since in 1984 we were able to withdraw some highly unsatisfactory special reliefs for people working overseas in the light of the tax reductions previously made. It would look extremely odd to be increasing the scope of tax shelters shortly after a Budget containing large tax reductions.

23. The residence rules and the 100% foreign earnings deduction apply to everyone, so if they were changed the benefit would go far wider than the seamen we want to help. But if relaxations were targeted on seamen, that would be seen as unfair by the others who at present qualify.

24. This approach would probably be even less effective than a direct exemption for seamen because we would simply be redrawing the boundaries of a tax relief and - even with generous relaxations - some seamen would continue to fall the wrong side of the dividing line. Another big disadvantage is that no-one can be sure he is entitled to relief until he has spent the necessary time abroad. For both these reasons it would be very unlikely that the possibility of increased tax reliefs for the seamen would be fully reflected in reduced wages.

Conclusion

25. My clear conclusion is that there are very strong arguments against either changing the PAYE rules or granting seafarers special tax reliefs. Moreover, since they operate very indirectly on crew costs, and could not be confined precisely to the type of vessel we want to help, they would be likely to be bad "value for money". I thus see no <sup>SENSE</sup> role for taxation changes in achieving our objectives.

CONFIDENTIAL



FROM: MISS M P WALLACE  
DATE: 25 March 1988

PS/FINANCIAL SECRETARY

cc PS/Chief Secretary  
Miss Peirson  
Mrs Brown  
Mr A M White  
Mr Waller

**JAMES MACKIE BELFAST, PROPOSED ACQUISITION BY  
SECRETARY OF STATE FOR NORTHERN IRELAND**

The Chancellor saw Mr White's minute of 24 March. As I mentioned to you, he would be grateful if the Financial Secretary could take this on. For the record, his view was that there could certainly be no nationalisation. He suggested that Mr King might want to approach the Bank of England. *I have passed this thought* on to Mr King's office, and I believe that Mr White has passed the message on at official level.

The Chancellor is unlikely to attend Tuesday's meeting of E(A), so would prefer to leave this to the Chief Secretary. But since the Financial Secretary will be in the lead on this particular issue, he ought to go too. We agreed that you would sort this out with Cabinet Office.

A handwritten signature in cursive script, appearing to read 'Moira Wallace'.

MOIRA WALLACE

of. to Min 28/3

FROM: MARK CALL

DATE: 25 MARCH 1988

FINANCIAL SECRETARY

cc Chancellor *e*  
Chief SecretaryINDUSTRIAL CASEWORK: JAMES MACKIE & SONS LTD

I can see the political sensitivity of the potential closure of a firm employing 1,000 people in West Belfast. However, I am not entirely convinced that what amounts to nationalising a firm of questionable viability is in the long term interests of the Northern Ireland economy. The propping up of such industries delayed necessary changes in industrial structure for years in other parts of the UK.

2. There are some inconsistencies in Mr King's E(A) paper, and I think you should probe him on the prospects for a firm manufacturing textile machinery for jute and flax. In the first paragraph he says that Mackie is one of the world's leading firms in a sector with good market potential. If the future was so bright for Mackie then presumably it would be able to attract private sector finance.

3. His note goes on to say that neither Rothschilds nor Lazards were convinced that a private sector solution was possible. It adds that Coopers' view was that the company would not generate a return on investment. Add to this the point in paragraph 12 that the company is owned by a Trust, which has "proved wholly ineffective in giving any sense of direction to the company over the last decade", and I really start to question the long-term viability of the company.

4. The business environment of West Belfast can hardly be described as normal, and so this is not a straightforward decision. Indeed, one could hardly imagine a stronger case on social grounds. My only concern is that while propping up ailing industries is politically easier on the ground, it inhibits the development of new industries.

*Mc*

MARK CALL

FROM: A M WHITE  
DATE: 28 MARCH 1988

FINANCIAL SECRETARY

cc Chancellor  
Chief Secretary  
PMG  
EST  
Sir Peter Middleton  
Mr Anson  
Mr Philips  
Mr Monck  
Miss Peirson  
Mr Burgner  
Miss Noble  
Mrs Brown  
Mr Waller  
Mr Sharratt  
Mr Call

E(A)(88)21: JAMES MACKIE & SONS LTD

The Secretary of State is seeking colleagues agreement to his proposal that the Northern Ireland Industrial Development Board should take control of James Mackie & Sons and provide immediate assistance of £6 million followed by subsequent tranches totalling up to £14 million over five years.

2. He argues that he has been forced to contemplate such a drastic step because Mackie's main creditor would otherwise force the company into receivership with the immediate loss of 1000 jobs in the employment black spot of West Belfast. He believes that the closure of the largest employer in the area would convey the message that the Government were not concerned about the Catholic community and undermine his proposed new measures on equality of opportunity that were announced recently. He is concerned also about the effect on the Belfast engineering industry which is already in serious difficulties with Harland & Wolff's almost certain imminent rundown to eventual closure in 4 to 5 years time and with Shorts likely to experience significant job losses during that period as well.

3. He claims that alternative rescue vehicles, which would avoid taking the company into public ownership, have been sought but all attempts to involve the private sector as the sole or dominant partner, have failed. Despite that, the Secretary of State believes that the company could be returned to the private sector

after the restructuring and re-equipment programme has been completed in 4 to 5 years.

4. The Chancellor has commented that there should be no nationalisation but the the Bank of England may be able to advise Mr King on an alternative course of action. Mr Call's comments on the poor commercial and economic case for the proposed rescue of Mackies, correspond closely to those we have made to Mr King's officials and which are summarised in the note of Treasury officials' views the Cabinet Office have circulated as an addendum to E(A)(88)21 - they were accidentally omitted by the Northern Irish when they circulated the paper.

**LINE TO TAKE**

5. You should say that taking Mackies into public ownership is not an appropriate solution, even on social and political grounds. Such a step would be contrary to the main thrust of Government policies and, with difficult decisions ahead on shipbuilding, it would send the wrong signals.

6. Assistance to James Mackie cannot be justified on commercial grounds. Not only will there be no return on the £20 million that is needed to return the company to viability, the projected rate of return for the restructured company, which would only be worth £6-10 million if eventually sold would be below the rate that a private sector owner might reasonably expect.

7. There can be no certainty that the company can be returned to the private sector even after restructuring. Its eventual viability is questionable and there is a significant risk that the Government will not be able to dispose of Mackies and will eventually be forced to close the company anyway or subsidise it indefinitely. It is better that the decision to close is taken on commercial grounds by the present private sector management.

8. In any case, you should express doubts about the social and political arguments. The majority of workforce (70 per cent) are protestant and travel to work from outside West Belfast. After the proposed restructuring there will be at most 250 Catholics

employed in the company. If it is necessary to do something for employment in the area, there are better ways of meeting the Secretary of State's real objectives which are not to sustain an ailing engineering company. As events in the rest of the UK over the last 20 years demonstrate, attempts to shore up old and uncompetitive industries are futile and hold back economic regeneration.

9. If the Prime Minister and other colleagues are sympathetic to Mr King's dilemma and favour some form of assistance for Mackies short of public ownership, you should argue that the search for an appropriate private sector rescue vehicle should continue, with the active involvement of the Bank of England. (At the Chancellor's suggestion, Treasury officials have given the Secretary of State's officials contacts in the Bank of England who may be able to advise - we do not believe any approach has been made as yet). In the meantime, you should agree only that Mr King renews and, if necessary, extends his guarantees to the Northern Bank.

#### BACKGROUND

10. James Mackie is a textile machinery manufacturer located in Catholic West Belfast employing 1000, 30 per cent of whom are Catholic. The company's customers are mainly traditional textile producers in the developing countries although it does have also strong links with Northern Ireland textile manufacturers.

11. In 1977 the Mackie family severed its links with the business and transferred ownership to a trust set up to run the company for the benefit of the past and present employees. Funds owed to the Mackie family were replaced by an overdraft with the Northern Bank. Since then, there has been very little capital investment, and profits have largely been devoted to reducing the overdraft. This has led to increasing production difficulties with increasing lead times for orders to be met and declining product quality.

12. The company formulated a re-equipment and restructuring plan in 1986 which included proposals to diversify into manufacture of machinery for synthetic textiles. Coopers and Lybrand have



appraised the plan and while concluding that the company could be made viable, Coopers did not believe that sufficient private sector investment would be forthcoming to meet the criteria for Government assistance on commercial grounds. This opinion was confirmed subsequently by both Rothschilds in 1987 and Lazards earlier this year, who both failed to find any source of significant private funding for the company.

13. Lazards have also advised the Northern Ireland Industrial Board on the structure of possible Government assistance. Their proposal would involve the IDB acquiring up to 90 per cent of the company's shares plus other phased assistance. The total cash injection required over 4-5 years would be £20 million after which the company would be worth no more than £10 million and which could only be disposed of at a significant discount on that figure.

14. The immediate crisis has been brought about by the threat from the Northern Bank that it will put the company into receivership unless the Government commits itself to support the company. The overdraft is currently near the ceiling of £9.5 million, £2 million of which is underwritten by guarantees from the Secretary of State, one of which runs out at the end of March.

15. Mr King and his officials argue that the company's underlying financial position justifies support. This is to a large extent based on Mackies current order book which is based on its traditional areas of business. But in the medium term those sales are projected to decline and turnover can only be held at around current levels if there is a very significant growth of business in new products and markets where there is already strong international competition. We are extremely sceptical that the company under IDB control could command management of the quality needed to face the challenges that the restructuring and diversification present.

16. There are no direct public expenditure implications from Mr King's proposals as he proposes to find the resources from within his existing block budget. But this is under pressure, particularly on the law and order front and from Harland & Wolff's difficulties. Any additional demands at this time will make it more likely that Mr King will need to seek additional provision.

RECOMMENDATIONS

17. I recommend that you strongly oppose Mr King's proposal to take Mackies into public ownership. If colleagues are disposed to agree to some assistance for a rescue on social and political grounds, you should argue that the Bank should be asked to try to produce a private sector solution in which any Government role should be secondary and limited to short-term guarantees.



A M WHITE

From: THE PRIVATE SECRETARY



NORTHERN IRELAND OFFICE  
WHITEHALL  
LONDON SW1A 2AZ

28 March 1988

Dear Private Secretary

JAMES MACKIE & CO LTD

I enclose an additional note about Mackie's sales and marketing forecasts which your Minister may wish to see before the discussion tomorrow of E(A)(88)21.

Yours sincerely

*Martin Donnelly*

M E DONNELLY

SMN2381

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SOME COMMENTS ON MACKIES SALE FORECASTS AND MARKETING

(A) SALES

The sales forecast on which the company has based its financial projection for the period 1987/88-1992/93 are as follows:-

	1987/88	1988/89	1989/90	1990/91	1992/93
£ million					
Sales	23.1	26.5	24.5	25.0	26.0 (incl spares)

These sales forecast are production limited. In 1990 and 1991 the company plans to move site and the projected sales are based on what the company reasonably expects it will be able to manufacture given there will be disruption before during and after the move.

Sales forecasts are in line with the levels of business achieved in the past.

£5.15m of machinery sales representing 56% of the total machinery sales over the period are either firm contracts, contracts at an advanced stage of negotiation or potential contracts with good prospects identified to specific customers.

The orders in hand at present and other areas or immediate sales potential will support the achievement of machinery sales forecasts over the next 2-3 years.

The financial projections confirm that the company will be profitable on these conservative sales forecasts.

Coopers & Lybrand have stated that they believe the company's projections are conservative and capable of being improved.

(B) MARKETING

The potential level of business in the 4 major markets in which Mackies operates is as follows:-

Jute

£60 million of the potential demand for jute machinery is

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categorised as short to medium term (available within a 5-year period). The balance of potential sales are considered to be longer term prospects, perhaps spanning a further 8-year period.

The market for jute is located in Africa and the East, with the African countries providing the bulk of the short term sales potential.

The Indian market, which we understand has no longer a viable domestic machine manufacturer, is to be exploited. In 1987, the Indian government suspended a 102% import tariff on new technology jute machinery, to help revive and modernise its troubled jute industry.

Flax

In 1981/82, production of wet spun yarns by mills reporting to the Confederation of Linen and Hemp Spinners (CILC) was spun entirely on 25-30 year old machines. At current prices remaining sales of a total replacement programme is estimated by the company at £50 million.

The utilisation of the new equipment is substantially higher than that of the former machinery, thus replacement is now necessary at more regular intervals. Thus on the assumption that flax machinery would be replaced every 10 years this market would be worth some £10 million per annum on average.

However, the major producers of the world's flax are the countries in the Eastern Bloc and China. Without being able to quantify precisely their potential, these markets are considered to offer a substantial opportunity for business to the company. In 1981 the Eastern Bloc and China were reported to have produced 84% of the world's flax.

Cheaper and less automated versions of the Linmack will be promoted in Communist countries, for use in both wet and dry spinning of linen. This is likely to produce meaningful sales within several years and, in the meantime, the company will complete the European replacement programme.

Wool and Synthetics

The company's estimate of market potential of £120m is based on its view of demand over a 5 year period. Just under three-quarters of total world demand is projected to come from manufacturers of tufted carpets in Europe and the United States.

The Ringtron spinning machine, which was launched during 1987/88, will be marketed aggressively to increase the company's share of this market. Major opportunities exist in the replacement of ageing equipment in the United States which will be serviced by a new marketing company, Mackie Blalock.

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Europe is the other major source of business for wool/synthetics machinery.

Polypropylene

Market potential of £71 million has been forecast for polypropylene machinery over a 5 year period. Since this is a relatively new industry, this business is expected to result from expansion rather than replacement of existing machinery.

The polypropylene product range will be expanded to include the CX extruder and continuous filament equipment for hosiery and upholstery.

Company marketing objectives

The marketing objectives of James Mackie Ltd may be summarised as follows:-

- to achieve sales of £25.6 million in 1988/89 and maintaining turnover at £23-£26 million during the following 4 year period. This compares with sales (of machinery and spares) of an estimated £23.1 million in 1987/88
- to withdraw from contract engineering work so as to concentrate on the development of the company's own product range
- to shift the emphasis of the company's business from third world countries by penetrating US and European markets for synthetics and polypropylene machinery
- ultimately to develop meaningful exports to Russia and China; these countries reputedly accounting for some four-fifths of world flax production.

COMMERCIAL IN CONFIDENCE

*bf. with advice of*  
*28/3 30/3*

TO:  
PRIME MINISTER

FROM:  
KENNETH CLARKE  
28 March 1988

CH/CHEQUER	
REC.	28 MAR 1988
ACTION	MRS M E BEAON
COPIES TO	CST FST Sir P Middleton Mr Anson, Mr Monck Mr Burgess, Mr Moore Mr Seaman, Mr Waller Mr A White, Mr Evans Mr Guy, Mr Sharatt Mr Rutland Mr N willie

**BRITISH SHIPBUILDERS**

Introduction

1 Since we last met in November, BS losses on contracts have continued to rise. I have received a confidential report commissioned by my Department from Peat Marwick. This confirms my previous view that while there are signs the world shipping market is strengthening, there is unlikely to be any shortage of capacity to absorb the up-turn as and when it comes. Moreover, the recovery in demand is unlikely to last.

2 In the light of this, I have discussed the future of British Shipbuilders (BS) with the Chairman, John Lister, and his Board. They told me there was no prospect of a sustained

return to viability without significant on-going Government support. Lister accepts that we should bring subsidies to an end and I believe he would be prepared to see through a run-down.

3 I told the Board my first preference would be to dispose of the Corporation's businesses to the private sector. My second preference was closure when the work ran out backed by a substantial package of measures. There have been significant recent developments on the possibility of disposals.

#### Govan

4 Kvaerner Industries, a Norwegian company specialising in gas technology, have written to me to say they wish to open serious negotiations for the purchase of Govan. Kvaerner believe they would need to reduce overheads and manning from 1800 to 1350 but, with the right support, could recover the yard. Once established in Scotland, they also say the UK could become the natural home for a range of marine and engineering activities presently located in Norway.

5 My best estimates for the cost to BS of closing Govan are shown at Annex A. If Govan were sold to Kvaerner, we might achieve cost savings of up to £75m.



6 Kvaerner have told my officials that they could only consider coming were they granted Intervention Fund or the equivalent at the present maximum rate of 28 percent for orders for three ships during this year. This would cost £35m. Subsequently they say they would want the same support as was available for other UK yards and the opportunity to talk to us before any decisions were taken to remove it. On BS costs alone, the Exchequer would be better off if any support over and above the £35m was less than a further £40m. Disposal of Govan would also avoid wider costs, including the consequences for our trade with China of delay being caused during the closure of a yard to completion of their existing order for two ships.

7 I would not wish to offer open-ended Intervention Fund support to a purchaser of any BS yard. I therefore propose that negotiations with Kvaerner be conducted on the basis of a cash provision of up to £75m. I would prefer to see this given by way of Industry Act or Regional Assistance grants authorised by the Secretary of State for Scotland. This apparently generous approach would actually save the taxpayer money compared with the alternative of early closure, quite apart from the inevitable additional costs of the yard if it continued to trade as part of BS. I must warn colleagues, however, that the negotiations may fail on the basis of our refusal of Intervention Fund support which would be contrasted with the situation in the rest of Europe.

NESL Sunderland

8 The future of the NESL yards at Sunderland is now at immediate risk. I have agreed with Lister that BS should give notice of default on Wednesday 30 March to Johanssen, the Danish entrepreneur responsible for the programme of 24 ferries, on grounds of his failing to meet obligations. Johanssen would have until 13 April to make good his defaults. If he fails, we would be left with a decision as to how many of the series of ferries BS should complete. BS estimate they could avoid losses by completing the first fourteen. My officials are urgently discussing this with Treasury.

9 The only possible interest in NESL is Sumitomo, who have visited recently and promised technical consultancy to improve work organisation on the shop floor. They might conceivably make an offer for the yard, but are unlikely to do so until after the Summer.

10 Notice of default on Johanssen risks immediate press comment. I will say at first that this is a contractual matter for BS and their customer to resolve but, if Johanssen does not meet his obligations, I may be forced into a statement as early as the week beginning 11 April. I will need to decide whether to say I was discussing the consequences with BS or to announce

the closure of the yard following the completion of a given number of ferries. In my opinion it would be quite essential that any announcement of closure would be linked with the announcement of my package of remedial measures for Sunderland.

11 I will also need to consider what should be said at the same time about negotiations for the disposal of all the other BS facilities. In my view a comprehensive statement would be necessary. This might also serve to attract further interested parties beyond those already identified.

12 In due course, I would need to make a further announcement of either the success or failure of the Kvaerner negotiations for Govan. If the negotiations were to fail, and no other interest had emerged, I do not think we would have any real option other than to announce the closure of the yard.

#### Other Yards

13 A private sector consortium wants to negotiate for Appledore at Bideford in Devon. The team involves a previous Chairman of the yard and the retiring Managing Director of the yard's main customer. Many of the 525 jobs could be saved.

14 There is little prospect of saving the 400 jobs by disposing of the Ferguson yard at Greenock. There are, however, prospects for a management buy-out at enginebuilders Clark Kincaid at Greenock and for disposing of the service company Marine Development Consultants employing 250 at Sunderland and Dundee.

#### Alternative Measures for Sunderland and Bideford

15 Whatever the progress on disposal, at least half the present workforce of BS will become redundant over the next year or so. If the ferry contract fails, substantial redundancies in the North East could begin very soon. I do not believe we can meet the overall threat without arranging for counselling, training and placement services throughout our yards with related enterprise work, and with a particular emphasis on measures that will lead to the provision of substantial factory space in the North East. This would be associated with a creation of an Enterprise Zone as Nicholas Ridley has recently proposed. I have worked up the detail of a package in Annex B which I believe must be introduced if the BS yards in England are to close. In my opinion, any attempt to pare down these proposals significantly would not be justified in view of the scale of savings likely to accrue to the Treasury in the longer term from closure. A lack of ambition in our measures would also ensure political disaster.

Recommendations

16 I invite my colleagues to agree:

(i) There is no prospect of returning BS to viability. There should be no more support for new orders in BS yards. Its facilities should be disposed of as quickly as possible or closed as soon as present work runs out.

(ii) It will be difficult to follow this policy if Harland and Wolff were treated differently.

(iii) Intervention Fund for all private sector yards should end in three years time.

(iv) Disposal of any BS facilities, including support for purchasers, should not cost the Exchequer any more than the costs already envisaged in closing them. Support to purchasers should take the form of up-front lump sums and in a form other than Intervention Fund.

(v) A new enterprise company in Great Britain should be formed, and operated through BS. This should have the means available to counsel, train and place redundant employees, and to conduct local enterprise work. In the North East, it should also have responsibility for

ensuring that the necessary factory provision takes place.  
At the same time we should establish the new Enterprise  
Zone proposed by Nicholas Ridley.

(vi) We should be prepared to spend up to £35m in the  
North East, and £3m at Bideford should the disposal of  
Appledore fail.

(vii) We should be prepared to make an early announcement  
about the future of the BS yards as soon as the House  
returns from the Easter recess.

I am sending copies of this to Nigel Lawson, David Young,  
Malcolm Rifkind, Tom King and to Sir Robin Butler.

*Peter Smith*

PP KC

*(Approved by the Chancellor  
and signed in his absence)*

## ANNEX A

## COST OF GOVAN CLOSURE

These figures set aside costs and income associated with the existing China contract which are common to both cases. They do not include the costs of any remedial measures.

	Govan Closes	Kvaerner purchases	Savings from sale
Under-recovered labour/overheads	30	10 +	up to 20
Redundancies	20	5 +	up to 15
Capital spend	5	-	5
Contingencies*	35	-	35
	<hr/>	<hr/>	<hr/>
	90	15 +	up to 75

\*Includes cost of disruption, terminal bonuses and liquidated damages because of late delivery.

DRAFT

**MEASURES TO ALLEVIATE EFFECTS OF SHIPBUILDING REDUNDANCIES  
IN ENGLAND**



**INTRODUCTION**

1. This paper seeks to identify a package of initiatives in Sunderland and Bideford that might be announced in response to a Ministerial decision to implement Option 1 in the BS Corporate Plan. The aim is to produce cost-effective measures which would hold out the prospect of promoting job opportunities over a reasonable timescale commensurate with the prospective job losses.

**Unemployment effect**

2. A decision by Ministers to implement Option 1 would lead to approximately 2760 redundancies at three BS establishments in the Sunderland Travel-to-Work Area (TTWA) and approximately 524 redundancies at the BS establishment in the Bideford TTWA. The time profile of these redundancies is shown in Table 1 as are the new jobs likely to be created by the recently announced Nissan expansion which is to be supported by £25 million regional assistance.

Table 1

Job losses/gains in the Sunderland and Bideford TTWA 1988-1992

	1988/89	1989/90	1990/91	1991/92	<u>Overall effect</u>
<u>Sunderland TTWA</u>					
Direct BS job losses	-560	-1800	-400	-0	-2760
Direct gains	0	0	+100	+900	+1000
<u>Bideford TTWA</u>					
Direct BS job losses	0	-524	0	0	-524

3. It is difficult to forecast the effect of these figures on total unemployment. Tables A and B (Annex 1) show pessimistic and optimistic assumptions respectively for the Sunderland TTWA and Tables C and D (Annex 2) show pessimistic and optimistic assumptions respectively for the Bideford TTWA.



4. On the most pessimistic assumptions unemployment in Sunderland would rise from a base of 18.1% to a maximum of 19.6% in 1990 before falling. In Bideford it would rise from a base of 16.2% to 21.1% in 1989 before falling. On the most optimistic assumptions the unemployment rate in Sunderland would continue to fall, but at a significantly reduced rate compared with the previous 12 months. In Bideford there would be a sudden rise to a maximum of 18.9% in 1989 before the previous downward trend was re-gained. The outturn in both areas is likely to be somewhere between the pessimistic and optimistic assumptions. The effect on the rate of unemployment in both areas will depend above all on the underlying trend in unemployment. The scale of the problem is, therefore, best assessed against the general background of continuing high absolute levels of unemployment in the TTWAs, and by reference in Sunderland to potential peaks of approximately 1800 shipbuilding job losses in 1989 and job gains from Nissan which peak at 900 in 1991 and in Bideford to a loss of approximately 524 shipbuilding job losses in 1988/89.

#### Existing/planned measures in Sunderland

5. In recognition of Sunderland's current high level of unemployment and other economic problems there are a number of agencies and instruments already operating in the area. These include:

(a) The DTI instruments associated with Sunderland's Development Area status. Following the abolition of RDG these are principally Regional Selective Assistance, enhanced levels of support for business consultancy under the Enterprise Initiative and, as from 1 April 1988, investment and innovation grants for firms with fewer than 25 employees. As a guide to the level of expenditure on RSA in Sunderland £3.7 million was spent in the first ten months of the 87/88 financial year compared with an average of £3.2 million for each of the previous four years.

(b) English Estates is the public sector factory building agency in Sunderland outside the Washington Development Corporation area. Although it is impossible to be precise about such figures English Estates' known planned expenditure in the TTWA in 1988/89 is £2.56 million on present projections. The cost of projects completed in the previous 12 months was approximately £1.5m. English Estates have also identified a number of strategic sites for future development in Sunderland, but the current level of demand on their resources is such that they cannot plan starts for any of these potential projects (see

paragraph 13 below).

(c) The Sunderland Economic Regeneration Team (SERT) is a valuable coordinating mechanism for the central Government departments involved in economic regeneration, the UDC, English Estates, the local authority. It has no resources of its own.

(d) The Northern Development Company (NDC) Apart from its substantial work in promoting inward investment, NDC undertakes a variety of activities aimed at assisting economic regeneration and promoting awareness of the region's strengths throughout the UK. These latter activities are sustained by a budget of £460,000 in 1987/88 (of which £210,000 was provided by central Government) and do not involve direct support for job creation.

(e) Sunderland Borough Council is one of the local authorities invited to submit an Inner Area Programme for support through the Urban Programme. It devotes some 60% of its annual allocation to projects assisting economic regeneration. Although Sunderland made effective use of additional Urban Programme resources at the time of the last redundancy package, the UDC may now be a more appropriate channel if additional resources were to become available. Sunderland's provisional urban programme allocation for 1988/89 is £4.4 million which is broadly in line with expenditure over the previous 12 months.

(f) The full range of Department of Employment/MSC employment and training measures would be available to help redundant BS employees. But taking into account the increasing priority now being placed on the long term unemployed and existing programme and resource levels it is open to question whether DE/MS C could provide special support for major BS redundancies in Sunderland and Bideford equivalent to that provided by British Shipbuilders Enterprise Ltd in 1986/87.

(g) The Tyne & Wear Urban Development Corporation (UDC) which was set up in May 1987 with a proposed budget of £160 million over the next 6/7 years. In its first 9 months of operation it is expected to spend only £4 million but in subsequent years this is expected to rise to approximately £20 million per annum. It has powers to acquire, reclaim and service land in order to promote development. Its current programme does not include treatment of the land now in active use by British Shipbuilders. It is not currently envisaged that the UDC would itself build

factories.

#### Existing/planned measures in Bideford TTWA

6. The range of measures available in Bideford is more limited, not least because it is not an Assisted Area and does not receive support under the Urban Programme. The following measures are relevant.

(a) From 12 January this year companies in the Bideford TTWA have been eligible for the nationally available business consultancy support under the new Enterprise Initiative.

(b) As in Sunderland, the full range of Department of Employment/MSD employment and training measures would be available to help redundant BS employees.

(c) Part of the Bideford TTWA qualifies as a Rural Development Area, though there have been no Development Commission small factory projects in the area in the last three years owing to the unavailability of sites.

(d) As a result of discussions currently taking place in Brussels the UK may put forward Bideford as one of the areas to benefit from ERDF measures under the RENAVAL programme. In such circumstances it would qualify for the higher rate of consultancy grant under the business development consultancies and for innovation and investment grants under the regional initiative for firms with less than 25 employees.

#### The contribution of existing/planned measures in responding to new redundancies

7. The optimistic unemployment projections in Annexes A and B assume the continuation of the existing downward trend in the level of unemployment in each of the TTWAs. Whilst it is impossible to predict in quantitative terms the contribution of each of the above instruments/agencies to the creation of new jobs, the unemployment trend is in part a reflection of the continuing operation of these existing measures. It is worth noting, however, that in Sunderland the influence of the UDC's activities has yet to be strongly felt. It can be expected to have an increasing impact on economic development in the area with a consequential beneficial impact on the unemployment rate.

8. There is some limited scope for strengthening the impact of existing measures in the two TTWAs concerned. An obvious example is the effort devoted to promoting the elements of the Enterprise Initiative and in particular the

investment and innovation grants for small firms that will be available in Sunderland and perhaps Bideford.

#### Additional measures

9. If Ministers judge that additional measures are necessary, there are the following possibilities.

#### A new enterprise company to operate in both Sunderland and Bideford

10. When the last major tranche of BS redundancies were announced in May 1986 the Government's response was the creation of British Shipbuilders Enterprise Ltd. Its primary objective was to help the redundant BS employees find new work, and its main focus was on counselling, training and re-employment activities. Its total expenditure until its demise at the end of 1987 was £5.2 million of which approximately £850,000 was spent by way of grants and loans to support new businesses and business development. By the end of its operation 99% of those made redundant had received counselling, 4% had started their own businesses, 48% had been on, or been approved for, training courses and 62% of those who had completed training courses had found new jobs.

11. In view of the nature and scale of the potential redundancies now under consideration DTI Ministers consider that there is a strong case for creating a new enterprise company under the aegis of British Shipbuilders. The new company would have the following functions:

(i) to offer counselling and retraining services to redundant workers so that those affected were given the same level of assistance as their predecessors in 1986/87. On the basis of experience with the previous redundancies about £5.4 million would be required over the period until 1992/3.

(ii) to provide funding for enterprise activities undertaken by former BS employees. BSEL has concentrated its efforts on counselling and retraining with nearly half of those made redundant now in jobs and 98 new companies started. DTI Ministers believe that a new BS enterprise company should have a higher profile in the enterprise area more akin to BSC(I) which has provided loan and equity finance for the encouragement of new businesses in areas affected by steel closures. The DTI view is that an appropriate level of resources over the period until 1992 would be about £6 million. It is

impossible to lay down in advance how this would be split in terms of loans (normally up to £10,000) and grants (up to £750 towards start-up costs).

(iii) to support the development of an industrial park in Sunderland, as detailed in paragraphs 13 and 14.

#### Enterprise zone for Sunderland

12. The Secretary of State for Environment has submitted to the Treasury a proposal to create an Enterprise Zone for that part of Sunderland to the East of the A19. DTI Ministers strongly support this proposal. Preliminary estimates suggest that an EZ covering five sites (Castletown, Hylton Colliery, Deptford Yard, Southwick and North Sands) covering 150 acres might lead to the creation of approximately 1400 net additional jobs over the 10 year life of the EZ. This would be an important element in the success of the UDC and should help to encourage private sector investment in factory development in the area.

#### Industrial park for Sunderland

13. There are no industrial premises over 10,000, square feet available anywhere in the Borough and on present plans no such factory building is envisaged until 1989/90 at the earliest (with the exception of a 20,000 sq ft factory being built by the local authority at Rainton Bridge). The Tyne and Wear Development Company have recently made representations to Ministers on the subject. English Estates acknowledge that there is a serious shortage of space in the 10-30,000 sq ft range, but they do not have the resources to allow them to build this year or probably next. In recent months there has been a steady increase in enquiries for factory units throughout the Borough. It is reported also that Washington Development Corporation is having to turn away enquiries. The experience of the UDC and local estate agents confirms the view that demand for large scale units is outstripping supply.

14. This suggests that one effective way of responding to the potential BS job losses would be to secure the provision of substantial additional factory space by way of an industrial park spread over several sites. The detail of such an initiative and the level of public sector resources required to support it depends in part on whether it is decided to create an Enterprise Zone with the associated incentives to private sector developers. Moreover, given the sensitivity of the current exercise it has not been possible to discuss sites and costings with local agencies. With those qualifications in mind we have identified four sites (all of them under consideration for the EZ), which

could be developed with the aim of housing up to 1700 jobs at an estimated cost of £22 million. In the event that an EZ was established it would be reasonable to assume that part of that expenditure would be undertaken by private sector developers. The £22 million would be spread over a three year period. Details of possible sites, expenditure and associated jobs are at Annex C. It is impossible to give a precise profile of expenditure at this stage.

15. There are a number of uncertainties associated with the allocation of funds to support factory building but the new enterprise company described in paragraphs 10 and 11 above would be expected to have a role in establishing the most cost effective and economical way of developing the industrial park in the light of decisions about an Enterprise Zone.

### Conclusion

16. The total cost of this package of measures (excluding the Enterprise Zone and the cost of any activities undertaken by the enterprise company in Scotland) for which there is no DTI PES provision over the period 1988/89 to 1992/93 would be as follows:

	1988/89	1989/90	1990/91	1991/92	1992/3	Total
<b>Enterprise Company</b>						
<b>Training and counselling</b>						
Sunderland	£0.4m	£1.2m	£1.2m	£1.2m	£0.5m	£4.5m
Bideford	£0.15m	£0.2m	£0.2m	£0.2m	£0.15m	£0.9m
<b>Enterprise activities</b>						
Sunderland	£1.0m	£1.0m	£1.0m	£1.0m	£1.0m	£5.0m
Bideford	£0.2m	£0.2m	£0.2m	£0.2m	£0.2m	£1.0m
<b>Running costs</b>						
Sunderland	£0.75m	£0.75m	£0.75m	£0.75m	£0.75m	£3.8m
Bideford	£0.15m	£0.15m	£0.15m	£0.15m	£0.15m	£0.8m
<b>2. Advance factories</b>						
Sunderland	<u>£7.6m</u>	<u>£7.6m</u>	<u>£7.0m</u>	-	-	<u>£22.2m</u>
<b>Total</b>	<u>£10.3m</u>	<u>£11.1m</u>	<u>£10.5m</u>	<u>£3.5m</u>	<u>£2.8m</u>	<u>£38.2m</u>

17. Following the precedent of BSEL, and using the powers

available under the BS legislation then used, DTI Ministers intend that the money to support these new measures should be channelled through an Enterprise Company established as a subsidiary of British Shipbuilders, with consequential effects on the Corporation's external financing limit.

Pessimistic and optimistic assumptions of the effect of job losses/gains in the Sunderland TTWA 1988-1992.

<u>Date</u>	(i) Table A		<u>Pessimistic assumption</u>		<u>Unemployment Rate</u>
	<u>Base unemployment</u>		<u>Net job losses (direct and indirect BS and Nissan)</u>	<u>Total unemployment</u>	
Feb 88	31,951		-	-	18.4%
April 88	31,380		-	-	18.1%
April 89	31,380		672	32,052	18.5%
April 90	31,380		2,698	34,078	19.6%
April 91	31,380		2,470	33,850	19.5%
April 92	31,380		1,344	32,724	18.8%

<u>Date</u>	(ii) Table B		<u>Optimistic assumption</u>		<u>Unemployment Rate</u>
	<u>Base unemployment</u>		<u>Net job losses (direct and indirect BS and Nissan)</u>	<u>Total unemployment</u>	
Feb 88	31,951		-	-	18.4%
April 88	31,380		-	-	18.1%
April 89	28,430		672	29,102	16.8%
April 90	25,758		2698	28,456	16.4%
April 91	23,311		2470	25,781	14.8%
April 92	21,120		1344	22,464	12.9%

The following assumptions have been made:-

- seasonal extremes are minimised by using October as the as the base month.
- 20% of redundant workers leave the unemployment register each year.
- for every job with BS there is one dependent job outside BS and 50% of the latter are in the Sunderland TTWA. This factor has been agreed after consultation with DTI and BS. From previous consultation we know that BS and the local authorities regard the 50% multiplier as very conservative in the Sunderland context.
- for every direct Nissan job created an additional job will be created in the Sunderland TTWA and of the total 2000 jobs created in the TTWA only 50% will be taken up by residents in the TTWA.
- Table A assumes the base unemployment rate in the TTWA remains at its projected April 1988 level.
- Table B assumes the base unemployment rate in the TTWA continues to decrease at a rate consistent with the fall in unemployment in the TTWA over the period October 1986 to October 1987. This fall in unemployment is seen as the best measure we have of the effects of existing measures to alleviate unemployment.

OOAABA



Pessimistic and optimistic assumptions of the effect of job losses/gains in the Bideford TTWA 1988-1992

(i) Table C Pessimistic assumption

<u>Date</u>	<u>Base unemployment</u>	<u>Net job losses (direct and indirect BS)</u>	<u>Total unemployment</u>	<u>Unemployment Rate</u>
Feb 88	1,502	-	-	16.2%
April 88	1,326	-	-	14.3%
April 89	1,326	- 629	1,955	21.1%
April 90	1,326	- 503	1,829	19.7
April 91	1,326	- 402	1,728	18.6%
April 92	1,326	- 322	1,648	17.8%

(ii) Table D Optimistic assumption

<u>Date</u>	<u>Base unemployment</u>	<u>Net job losses (direct and indirect BS)</u>	<u>Total unemployment</u>	<u>Unemployment Rate</u>
Feb 88	1,502	-	-	16.2%
April 88	1,326	-	-	14.3%
April 89	1,128	- 629	1,757	18.9%
April 90	960	- 503	1,463	15.8%
April 91	817	- 402	1,219	13.1%
April 92	695	- 322	1,017	11.0%

The following assumptions have been made:-

- seasonal extremes are minimised by using October as the base month.
- 20% of redundant workers leave the unemployment register each year.
- for every job with BS there is one dependent job outside BS and 50% of the latter are in the Bideford TTWA. This factor has been agreed after consultation with DTI and the BS; it represents a pro-rating of national figures and is the best available figure at the present time.
- Table C assumes the base unemployment in the TTWA remains at its projected April 1988 level; and Table D assumes that it continues to decrease at a rate consistent with the fall in unemployment in the TTWA over the period October 1986 to October 1987. This fall in unemployment is seen as the best measure we have of the effects of existing measures to alleviate unemployment.

## ADVANCE FACTORY OPTIONS : SUNDERLAND

In descending order of priority (in terms of ease of development, marketability and producing results) site options are:

1. Castletown

Can be developed quickly. Just outside UDC area but UDC would want to take it on. UDC/EE/Sunderland Borough Council/DTI all favour this site.

100,000 sq ft      230\* jobs      £2.5m (cost of factory building)

2. Hylton Colliery

Biggest site in UDC area. Owned by British Coal. Little to do by way of providing services : ready to build on. Good access. EE have already done design work.

162,000 sq ft      372\* jobs      £4.2m (cost of factory building)

£0.5m (cost of purchase from British Coal and site preparation)

Total £4.7m

3. North Sands

Inner area site on the river mouth. Sunderland Council keen to develop site for ro-ro terminal for Nissan but unlikely that UDC (and other agencies) will back this proposal as there are already ro-ro facilities on other rivers. So site may be available for factories. In UDC area and UDC regard site as important one for development. A large site (20 acres) it is currently in process of reclamation by Sunderland Council but developable land much less.

200,000 sq ft      460\* jobs      £5m (cost of factory building)

4. Deptford Yard

Owned by BS. Subject of consultants report. Located in inner area but will take 2 years to vacate and reclaim.

280,000 sq ft      644\* jobs      £7m (cost of factory building)

£3m (cost of acquiring and preparing).

OOAABD

Total £10m

Summary

	Area	Jobs	Cost
Castletown	100,000 sq ft	230	£2.5m
Hylton	162,000 sq ft	372	£4.7m
North Sands	200,000 sq ft	460	£5m
Deptford	280,000 sq ft	644	£10m
Totals	742,000 sq ft	1706	£22.2m

[Note: All four sites would fall within prospective EZ area].

Other site of interest (more distant from inner area)

5. East Herrington/Dexford Park (greenfield site)

4/5 miles south of inner area. Sunderland Council/EE see this as a strategic site for inward investors but needs roads, drainage and landscaping (at probable cost of £3m). EE may well develop site anyway when resources available.

\* 2.3 jobs per 000 sq ft

ID1A

March 1988

OOAABD



Agreed at mtg  
Jan X @  
Anna B by Clarke's  
Paper AS or  
Chambers.  
ML

SECRET

FROM: P M RUTNAM ✓  
 DATE: 29 MARCH 1988

1. MRS BROWN ✓  
 2. CHANCELLOR

cc Chief Secretary ✓  
 Financial Secretary ✓  
 Sir P Middleton ✓  
 Mr Anson ✓  
 Mr Monck ✓  
 Mr Moore ✓  
 Mr Burgner ✓  
 Ms Seammes ✓  
 Mr Waller ✓  
 Mr A White ✓  
 Mr R Evans ✓  
 Mr Guy ✓  
 Mr Sharratt ✓  
 Mr N Williams ✓  
 Mr Call ✓

*Ch. Content to write as proposed? 30/3*  
*OK as →*

**SHIPBUILDING**

You are attending a meeting chaired by the Prime Minister on Thursday 31 March to discuss shipbuilding. Mr King and Mr Rifkind will be present, as well as Lord Young and Mr Clarke. The issues to be considered are:-

- i) the future of British Shipbuilders and Harland & Wolff, and the terms of possible disposals; and
- ii) the employment measures associated with closure.

2. We recommend you to write to the Prime Minister in advance of the meeting to register your concern at the public expenditure implications of what is being proposed by Mr Clarke, Mr Rifkind and Mr King on employment packages, and your view that state support for the merchant shipbuilding industry must now come to an end. A draft is attached. The minute will need to be circulated to colleagues in the course of tomorrow (Wednesday) morning.

**Recent Developments**

3. Mr Clarke's minute of 28 March reports on developments since the Prime Minister's last meeting on this issue on

*This did not arrive until today 0/3*  
*attached*

SECRET

24 February. You will recall that at that meeting it was agreed that final decisions on the future of British Shipbuilders and Harland and Wolff would have to be delayed at least a month, pending the outcome of discussions with a Norwegian company, Kvaerner, that had expressed an interest in acquiring BS's Govan yard. During this period, officials were also to take forward work on the employment package for the North-East, where BS's other major yard, NESL, was running into major problems with its contract for a fleet of Danish ferries.

4. Mr Clarke now reports that:

- i) Kvaerner say they would only be prepared to take over Govan if they were granted Intervention Fund (or equivalent) support for three ships this year. This would cost the Exchequer about £35 million. Thereafter they would want continuing support for new orders, or an opportunity to talk to Government before that support was reduced (ie. to hold us to ransom).
- ii) The customer for the 24 ferries being built at NESL is to be given notice of default this Wednesday, 30 March. He will then have a fortnight to make good his default: he is unlikely to do so. A decision will then have to be taken on how many of the ships should be finished by BS. Mr Clarke proposes that the yard should close as soon as this residual work is completed. Sumitomo might just have an interest in taking over the yard, but no developments on this score would be likely until after the summer. There

SECRET

may be pressure for a statement on the future of the yard and/or BS as a whole, as early as the week beginning April 11.

iii) There are possibilities for the disposal of BS's minor facilities, including a consortium interested in buying the yard in North Devon at Appledore, and prospects for a management buy-out of engine builders Clark Kincaid at Greenock.

iv) Employment measures to offset the redundancies are set out in Annex B to Mr Clarke's minute.

5. Mr Rifkind and Mr King will also be circulating papers which will argue for very substantial expenditure on employment measures. They are likely to argue at the meeting for Intervention Fund assistance to continue.

Govan

6. Mr Clarke proposes to continue negotiations for the disposal of Govan to Kvaerner, but on the basis that the deal agreed with the company should cost the Exchequer no more than would the rundown and closure of the yard under BS's ownership. He rejects any suggestion that the deal should include an open-ended offer of Intervention Fund support to the purchaser. He proposes a figure for a cash payment to Kvaerner of up to £75 million to be included in the deal. This would be made up of £35 million to support the first three ships that Kvaerner intend to build at the yard, and then provision for a 'dowry' of up to a further £40 million.

7. Mr Clarke proposes that these costs are met by the Scottish Office through Industry Act or regional assistance grants. Mr Rifkind will resist, on the grounds that the deal would be financed from savings on costs which would otherwise fall on BS. The only alternatives are a transfer from DTI votes, or a substantial claim on the Reserve. Existing provisions

SECRET

for the BS EFL are inadequate. You are recommended to press for absorption of the costs of a deal on Govan from overall PES by the Scottish Office and/or DTI. As to the nature of the assistance offered, of Mr Clarke's two suggested options, the 1980 Industry Act powers seem inappropriate (assistance is restricted to ex-NEB subsidiaries) and regional assistance under S.7 of the 1982 Industrial Development Act is likely to add to pressures on Mr Rifkind's regional assistance budget. There is no need to decide the form of any dowry to Kvaerner at the meeting, as long as it is clear that it must not involve the Intervention Fund.

8. Subject to that and the reservations below, Mr Clarke's approach and calculations are acceptable, and we recommend you to support his proposal. The savings that should arise from transfer of the yard and sub-contracting the completion of the China ships are shown at Annex A to his minute.

9. It should be pointed out that there will also have to be negotiations with Kvaerner over the sub-contract for the completion of the China ships. If Kvaerner challenge BS's costings, there will be a risk of extra costs falling to the Exchequer. Given BS's poor costing record, there is likely to be a good deal of argument on this point, and we will need to ensure that any upward revision of the costings is reasonable. It will also be important to ensure that there are adequate safeguards attached to any sums given to Kvaerner up-front.

10. Mr Clarke says that Kvaerner may refuse a deal that does not involve an offer of continuing subsidies, rather than a dowry, but that if the yard cannot be sold on these terms it must close. Mr Rifkind is unlikely to agree. He may argue that we should be prepared to offer Kvaerner Intervention Fund or equivalent continuing assistance to ensure that they come in. Mr King may also argue that Harlands should not be debarred in principle, from further Intervention Fund-<sup>type</sup> grants to help them win new orders, the cruise ship for Tikkoo in particular. You are recommended to support Mr Clarke strongly in rebuffing any extension to the life of the Intervention Fund for the following reasons:



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i) there is no realistic prospect of merchant shipbuilding in the UK making a sustained return to viability - this is the conclusion of all the market analyses that we have;

ii) there is no strategic case for supporting merchant yards;

iii) therefore the only rationale for subsidies is to preserve jobs; but as a job support programme the sums involved represent indefensibly poor value for money.

NESL and other yards

11. On NESL Mr Clarke's proposal is that the yard should close as soon as it has completed any residual work that is cost effective. This is acceptable. On the smaller facilities which might be sold, such as Clark Kincaid and Appledore, we do not know the likely terms of the disposals. We would need to look at any proposals very carefully.

Handling: the public announcement

12. Mr Clarke expects to have to make a statement on BS when the House returns after Easter, but is not sure what its terms should be. In particular, he leaves open the possibility of not announcing the closure of NESL despite the default of its customer. We think that the closure of the yard should be announced to forestall any pressure for it to take further loss-making orders. A firm announcement on NESL after Easter would also help prepare the way for statements on other yards later in the Spring. Ideally Mr Clarke's statement should also indicate that no further Intervention Fund grants will be made to any BS yard including Govan - ie. that BS will not take any more loss-making orders. This might, however, disadvantage us in negotiations with Kvaerner: we recommend you press Mr Clarke to announce the end of Intervention Subsidies to BS, but accept that this may have to be reconsidered in the light of disposal negotiations.

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Measures to alleviate shipbuilding redundancies

13. For England Mr Clarke has proposed the provision of counselling and retraining, together with enterprise promotion measures and a major new programme of factory building in the North East. He also supports Mr Ridley's proposal for an Enterprise Zone in Sunderland. Taken together with the cost of the recent offer of £25m regional assistance to Nissan this would involve expenditure of some £86m.

14. For Scotland Mr Rifkind will be proposing a substantial package, again with a very large element of factory building. Including the cost of the Enterprise Zone for Inverclyde this would involve expenditure of not less than £71m.

15. For Northern Ireland Mr King will be proposing even more substantial measures costing some £94m.

16. In addition to concerns about the scale of these packages and the failure to address how these would be financed, covered in the draft minute attached, we have severe reservations about the likely value for money of some of these proposals. We have particular reservations about the proposed Enterprise Zone for Sunderland, where preliminary examination with DoE officials has suggested that the costs may be substantially greater and the benefits substantially less than suggested in the paper circulated by Mr Ridley.

Recommendation

17. We recommend that you:

i) accept Mr Clarke's proposal for the terms of the possible disposal of Govan to Kvaerner, including a cash package of up to £75m;

ii) firmly reject any suggestion made by Messrs King or Rifkind that Intervention Fund assistance or the equivalent should continue to be available to BS or Harlands, or that a deal with Kvaerner should include continuing subsidies;

SECRET

iii) press Mr Clarke to announce the closure of NESL as soon as possible after the period of notice of customer default has expired, and argue that this is also the right time for announcing the end of Intervention subsidies for all BS yards;

iv) A separate brief on Harlands with a line to take is below. The draft minute to the Prime Minister, emphasising the disproportionate cost of the employment packages proposed is attached.

This brief includes contributions from IAE. ST's Annex on Harland's is attached.

*P. M. Rutnam*

P M RUTNAM

Harland and Wolff

The position on Harland and Wolff has been complicated by the fact that the company has been negotiating with Ravi Tikkoo for the construction of a large cruise liner (P3000). Detailed proposals will be put to Mr King in late April and, as the proposal has achieved wide local publicity, he is now reluctant to take discussions on Harland and Wolff until those have been evaluated. He suggests that it will be late May before he could make an announcement (but that date will almost certainly slip).

2. The order would represent four years work for the yard and Mr King says he would be subject to enormous criticism if he announced decisions on the yard before giving it consideration.

3. Mr King anticipates that his consideration of the order will lead him to conclude that, without massive support, it would not be a viable proposition. If that is the case he accepts that refusal to support the order, tantamount to a decision to close the yard, would be the decision he would reach in May. If, however, the order appears to be feasible he would wish to negotiate with Ravi Tikkoo and the yard's management:-

either

(a) a higher price to aim off for Harland's notorious past underestimation of contract costs and a penalty/bonus system for the labour force to increase cost discipline;

or, if attempts are made to fob him off with assurances on these points

(b) privatisation of the yard on the basis of the P3000 order, with a substantial financial inducement to the new owners (yard management plus Tikkoo) to cover known losses on existing orders and to subsidise the P3000.

He also believes if privatisation is to be achieved, the new owners would press strongly for continuing access to contract support for new orders within the limits of the EC Sixth Directive

### Remedial Measures

3. Mr King argues that whatever option is followed, there will be considerable redundancies over the next few years and that, should closure take place, he must undertake a package of remedial measures at an estimated cost of £94m over the five years to 1992-93. He makes it clear that he would need additional provision to fund these measures as, having to bear substantial redundancy/closure costs over that period he could not accommodate the cost of these remedial measures within his block. He accepts that further work by officials, which his proposed timetable would allow for, should be done on his package in the light of decisions on British Shipbuilders remedial measures.

### Comments

4. Given Harland's track record there can be no great belief, even among Mr King's officials, that the P3000 order could be a commercial prospect. But unfortunately Mr Parker and Mr Tikkoo have achieved substantial local publicity for their negotiations and it would clearly be difficult for Mr King to announce closure now before considering the proposed cruise liner contract.

5. There is, however, a clear risk that unless, as Mr Clarke proposes, the Intervention Fund is now closed to publicly owned yards that Mr King will be convinced that it could be built by Harland's at containable cost.

6. If so, then his proposals to seek realistic pricing and cost capping may bring the underlying realities home to him.

7. If rather, they convince him that a sale of the yard to Harlands management and Mr Tikkoo is a real possibility, there should be no question of continuing Intervention Fund <sup>the</sup> assistance

to Harlands. As is proposed for Govan assistance should be an up front downy with no continuing support.

### Line to Take

8. Resist any suggestion that Intervention Fund should be available to Harlands on a continuing basis, drawing on the arguments in paragraph 10 of the covering brief.

9. Accept that Mr King must consider the P3000 but that the outcome of that consideration should be rejection unless either:-

(a) it can be built on a fully commercial, profitable basis

or (b) privatisation can be agreed with only an up front downy amounting to less than the costs of closing Harlands.

10. Accept that further work on remedial measures for closure should follow decisions on BS yards, and be in scale with them. Present £94m package excessive. Consideration of bid on reserve could only follow agreement on sensible package.

11. If Mr King says closure of Intervention Fund means he cannot reasonably consider P3000 order, press for statement that as Fund is closing only fully commercial orders can be taken by Harlands and if no such orders secured then yard will close on completion of AOR.

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PWP

FROM: J J HEYWOOD  
DATE: 29 MARCH 1988

**PS/CHANCELLOR**

cc: PS/Chief Secretary  
PS/Paymaster General  
PS/Economic Secretary  
Sir P Middleton  
Mr Scholar  
Mrs Case  
Mr Revolta  
Miss Sinclair  
Mr A R Williams  
Mr Cropper  
Mr Tyrie  
Mr Call  
PS/IR

**SHIPPING**

I have already passed on to you by telephone the Financial Secretary's comments on Miss Rhodes' submission of 29 March.

2. For the benefit of copy recipients, the Financial Secretary's comments were as follows:

- (i) there is little to be gained from offering a relaxation of the residence rules. This would probably have little effect and would be repercussive;
- (ii) there should not be an Annex on overseas comparisons, but the Chancellor might like to have the information at his finger-tips during the meeting with the Prime Minister;
- (iii) the section on the repercussive effects of a PAYE exemption should be included in the paper.

J J HEYWOOD  
Private Secretary



OK - (initials)

Ch.

FST has considered Miss Rhodes' note (attached). He has not had time to discuss with officials.

2. He thinks:

- (i) We should not make a relaxation of the residence rules; it would not offer a significant improvement, and would be repercussive;
- (ii) We should not include the international comparisons - not particularly helpful to our position;
- (iii) We should include the suggested para. on repercussive effects of PAYE (see para 6 of Miss Rhodes' note).

3. If you agree, I will get a final version typed up for me to send over to Mr Gray.

25 29/3





Inland Revenue

*APB*

 Policy Division  
Somerset House

 FROM: ANGELA RHODES  
DATE: 29 MARCH 1988

- not seen*
1. MR ISAAC
  2. FINANCIAL SECRETARY

SHIPPING

1. Following your meeting with the Chancellor at which Mr Lewis' note of 25 <sup>March</sup> ~~September~~ was discussed we understood you wanted further details on the following points:

- a minor relaxation of the residence rules
- international comparisons
- the repercussive effects of allowing shipping companies not to operate PAYE.

This note deals with each of those points in turn.

Relaxing the residence rules

2. We have looked at whether it might be possible to relax the residence rules in a way which did not have repercussive effects. We have concluded that it is not. The rule that offered the best opportunity is that under which a seafarer is

cc Chief Secretary <i>FST</i> <del>Financial Secretary</del> <i>[CHANCELLOR]</i> Paymaster General Economic Secretary Sir P Middleton Mr Scholar Mrs Case Mr Revolta Miss Sinclair Mr A R Williams Mr Cropper Mr Tyrie Mr Call	Chairman Mr Isaac Mr Painter Mr McGivern Mr Lewis Miss Rhodes Mr Fraser Mr I Stewart Mr K Allen PS/IR
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treated as non-resident if for a period which includes a complete tax year he serves on ships which during the period of his service do not begin or end a voyage in the United Kingdom or call at a United Kingdom port or anchorage. We have looked at whether the embargo on calls to the UK during a voyage could be lifted in any way.

3. The first point to make is that if any duties performed while in the UK port are merely incidental to the duties performed elsewhere, non-resident status will not be lost. So if a ship has to call unexpectedly, say for emergency repairs, but not as part of her voyage, her crew's non-resident status is not likely to be jeopardised.

4. Where a ships calls here as part of a voyage, the crew will lose non-residence status because they will be performing part of their duties here. It would of course be possible to amend this to include short stays in a UK port, but there are a number of objections:

- it may only be of limited help to seafarers - it does not help where the ship begins or ends a voyage in this country
- it is not clear how long the period of grace should be. But any line is bound to be arbitrary and some people will inevitably fall the wrong side of it - possibly for reasons beyond their control (eg it took longer to load/unload the ship than was expected). This could seem very unfair
- it would be repercussive

5. Although couched here in seafaring terms this rule is of general application - S335 ICTA 1988 (formerly S50 ICTA 1970). As you will know, any person who has accommodation available in the UK is treated as resident as soon as he enters this country. S335 displaces this rule for anyone who works full time abroad (whether as an employee or self-employed) no part

of the job is done in the UK. (There is let out for employees for incidental duties performed here). So where a voyage includes a UK port, part of the duties are performed here. Relaxing this rule therefore impacts on others - self-employed as well as employees.

6. More fundamentally however, this rule is tied up with the "available accommodation" rule. As you know, we are seeking to simplify the residence rules and the available accommodation rule is under particular scrutiny. A separate note on this subject is being sent separately. Any alteration to the rule would have knock-on effects for the rule in Section 335, abolishing this rule could profoundly affect it. In the time available, we have not had time to assess out all the implications. Indeed these very much depend on any changes that are made to the residence rules generally. But this does strengthen the argument against fiddling with the residence rules at the margin ahead of the larger review/consultation exercise.

#### International comparisons

7. Something along the following lines could be added - perhaps as an annex to the papers attached to Mr Lewis' note of 25 March:

"A large number of Western nations do not give special treatment to seafarers. These include Australia, Belgium, Canada, France, Germany, Ireland, Italy, Japan, New Zealand, Portugal, Spain and the USA. A recent report (Lloyds List, 28 March) however suggests that Canada is considering setting up a separate international shipping register, with special tax reliefs for ships listed on it. Further details are not available as yet, though it appears the reactions of the users of shipping lines are not favourable (The Transport Minister has said their support is essential).

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A number of other countries - mainly in the high cost area of Scandinavia have special rules - Denmark, Finland, the Netherlands, Norway. In general these have given seamen special deductions or allowances and/or preferential rates of tax. However the Danish Parliament is currently considering a Bill to create an international shipping register and to exempt seamen from tax on their earnings. The Swedish Government has announced that it is to grant income tax cuts to seamen and to provide subsidies to ship-owners to cover social security payments. Specifically the proposal is, from 1989 to abolish income tax for seamen on internationally operating ships, apart from ferries.

Greece has a special regime under which ratings do not pay tax on their earnings as seamen. Officers pay a flat rate of 5 per cent."

Repercussive effects of PAYE exemption

8. The following could be added to the note attached to Mr Lewis' paper - in paragraph 9 line 13 after "similar situation" insert

X  
"Many UK companies, particularly those operating in such areas as financial services, oil and computers, are currently operating PAYE in respect of individuals working for them in the UK but still employed and paid by their foreign employers. And it would not be particularly difficult for other employers to transfer their employment function to an offshore company and to seek, by analogy with the shipping industry, to remove any PAYE obligation."

AMR

A M RHODES

Prime Minister

HARLAND AND WOLFF

CH/EXCHEQUER	
REC.	30 MAR 1988
ACTION	MRS BROWN
COPIES TO	CST, FST, Sir P Middleton Mr Anson Mr Monck, Mr Moore Mr Burgess, Mrs Seaman Mr Walter, Mr A White Mr R Evans, Mr Guy Mr Sharratt, Mr N Williams Mr Rutnam, Mr Call

Introduction

1. When we met in November, we agreed to consider the future of Harland and Wolff along with DTI proposals for British Shipbuilders, so that the strategy towards merchant shipbuilding could be decided on a UK basis. Since then H&W has continued its negotiations for the construction of a large cruise liner. The more advanced stage of these negotiations now change somewhat the ways to handle the future of the yard. This paper sets out my proposals.

Background

2. If we decide to withdraw support from UK merchant shipbuilding, this will result in the closure of H&W in 1991 (following the completion of AOR 01). The impact of this on Northern Ireland generally, and on Belfast in particular, will be very serious. H&W is the second largest manufacturing company in Northern Ireland (after Shorts), and the number currently employed is larger than at any of the BS yards. The Northern Ireland economy is weak and a number of other manufacturing companies in Belfast including Shorts and Mackies are also facing severe difficulties. Northern Ireland has not shared in the recent growth in employment in the service sector and self-employment seen in GB. Closure of the yard would undoubtedly be a substantial blow to the morale and self confidence of business in Northern Ireland. I am also

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concerned about the likely political and security reaction at a time when there are real signs of possible progress on the political front, and when the UDA are in a disorganised and thus dangerous condition. This will in turn be affected by the circumstances of any closure, and whether it was seen to be unavoidable.

### P3000 Cruise Liner

3. I indicated in November that Harland and Wolff was pursuing with Mr Ravi Tikkoo a large cruise liner project (known as P3000) and expressed my reservations about the realism of the order. Since then considerable work has been carried out by independent consultants on both the potential market and on the design. John Parker has put together a proposal which he could publicly present as an exciting new project. Details of costings will not be available before the end of April and it will not therefore be possible for the proposal to be evaluated until early May. Ravi Tikkoo is very keen on building the ship and when I met him recently he stated his clear preference to have it built in Belfast to the H&W design. For their part, H&W is approaching the project in a markedly more professional manner and the market for cruise liners is one in which West European yards are more competitive than in other sectors.

4. It would be very damaging politically to make any announcement leading to closure before giving consideration to this proposed order. We would be subject to enormous criticism if we announced closure when the company could be presented (as it would be) as being on the verge of clinching a major order which would result in four years' work for the yard, and substantial work for a significant number of local suppliers.

5. Against that background, when I receive the costings for the project I would wish to examine, in this order, three separate possibilities:

- (a) I could not contemplate a repeat of the past experience of delay, overruns on cost and increasing cash demands which have such a disruptive effect on other economic and social priorities within the Northern Ireland Block. But I could not reject support for the order out of hand. What I propose is therefore to challenge the Yard on the assumptions underlying the costing of the order to the point where they categorically insist on the reliability of those costings and their ability to build the vessel to time and cost. I will then tell them that I am prepared to authorise them to take the order but only on the basis that H&W seeks a higher price from Mr Tikkoo to cover not only H&W's expected costs of construction but also an assumed overspend based on the yard's past performance; alternatively protection against cost overruns on an agreed contract price might be achieved through a capping mechanism which would transfer extra costs to Mr Tikkoo.
- (b) I recognise that these conditions will not be welcomed - especially by Mr Tikkoo - but they would represent a more positive response to the order than a straight refusal. Should Mr Tikkoo or, indeed, the management not be prepared to proceed on this basis, my second line of approach would be to offer ownership of the yard to the management, workforce, Mr Tikkoo or a combination of these subject to the confirmation of the order by Mr Tikkoo. I would

expect the new owners to complete the existing workload and would, therefore, need to offer a substantial financial inducement which would cover known losses on existing contracts and include an element of subsidy for P3000. I would also need to be able to offer a continuation of contract subsidy arrangements within EC limits for future orders. I would intend to follow closely the precedents set by the privatisation of BS yards and would anticipate that the costs of transfer would be below those necessary to close H&W. I would intend to contain this inducement within the Northern Ireland Block and indeed within provision currently made for H&W.

- (c) The final possibility if neither of the above was attainable would be to refuse to provide any aid towards the order. This means closure.

6. I believe that, in practice, any successful negotiation of privatisation will require some form of on-going contract support. Any new owner will perceive themselves as being unfairly handicapped against other EC competitors who can get contract and other subsidies. My view is, therefore, that we need to consider maintaining such contract support at some level within the EC sixth directive limits. Intervention Fund contract subsidies have, in fact, represented only a small proportion (15%) of our financial support to H&W over the last 5 years but this is partly explained by the fact that H&W's tender prices have been unduly optimistic.

#### Funding

7. Whatever the outcome, considerable funding will be needed by the company over the next few years. If the company is forced to close then the costs of closure, including redundancy



costs, possible termination bonuses and certain site works such as the demolition of the cranes, will be substantial - our current estimate is some £300 million. If privatisation did prove possible there would still be a considerable number of redundancies, the existing liabilities would have to be cleared and, as already noted, some inducement would have to be provided. While I would endeavour to finance these closure/privatisation costs from Northern Ireland Block resources I could not rule out a bid on the Contingency Reserve.

#### Remedial Measures

8. Each of the three options referred to above is likely to result in a considerable number of redundancies. I consider it essential that a package of remedial measures is introduced but I will be unable to do so to any significant extent unless additional resources are made available, in particular in the period when heavy closure/privatisation costs are also being borne by the Northern Ireland Block. If the only future is closure, then, taking into account other jobs within Northern Ireland dependent on H&W, I could be faced with some 5,000 redundancies in all. Attached at Annex 1 is a summary of the likely effects of closure on unemployment and an indication of some of the remedial measures I would like to introduce in these circumstances. The cost of these measures is estimated at £94m in the 5 years to 1992/93. I suggest officials should examine them further in the light of decisions reached on BS.

#### Conclusion

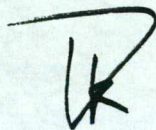
9. I am prepared to face closure of H&W but I have to take account of the proposed order for a cruise liner which H&W will shortly be presenting to me. I would find it politically very difficult (given my other current difficulties) to announce closure without being seen to give proper consideration to an

order which, in any event, might present an opportunity for privatisation. I would, therefore, wish to take the decision on H&W at the end of May, having completed the process of challenging H&W's costings and exploring privatisation.

10. Prospects for either course are not great but, if I am to have any chance of success, in the present world shipbuilding market I need to be able to offer similar terms - including financial inducements - as have been applied in the sale of some GB yards and as now proposed by the Chancellor of the Duchy for Govan and Appledore. These must include on-going contract support arrangements.

11. Whether or not closure takes place, there will be a need for remedial measures to offset the necessary redundancies and the resources to finance them. For closure, the cost of these measures in the five years to 1992/93 is estimated at £94 million.

12. I am sending copies of this to Nigel Lawson, David Young, Ken Clarke, Malcolm Rifkind and to Sir Robin Butler



TK

MEASURES TO ALLEVIATE THE EFFECTS OF SHIPBUILDING REDUNDANCIES  
ARISING FROM THE CLOSURE OF HARLAND AND WOLFF

Introduction

1. In the light of a possible Ministerial decision which could result in the closure of Harland and Wolff, this annex examines the need to alleviate the effects of such a closure and proposes a range of measures which could be introduced. These measures would also be needed on a smaller scale in the event of major redundancies short of closure.

Impact on the NI Economy

2. The closure of H & W would have a very serious effect on the Northern Ireland economy and in particular on its manufacturing base. H & W is the second largest manufacturing employer and its labour force constitutes almost 5% of the manufacturing sector. Furthermore the multiplier effect increases the overall number of jobs generated in the economy by the company.

3. The Northern Ireland economy has not shared in the recent growth experienced in GB. The unemployment rate stands currently at 19.6% and in the Belfast travel to work area it is 17.0%. Given the forecast increase in the size of the labour force (which is greater than the equivalent increase in GB) unemployment is already forecast to increase by 2% (or about 15,000) by 1992, and this takes no account of potential redundancies in H & W and other firms in the engineering

sector. Shorts could be declaring up to 3,000 redundancies if the aircraft division has to close and over 1,000 are at risk in Mackies. These firms represent the core of the engineering industry in Belfast.

Proposed Additional Measures

4. There is already a number of bodies and schemes available in Northern Ireland to assist job creation. Furthermore, in early 1987 Harland and Wolff Enterprise (HWEL) was set up to assist workers being made redundant, but it has had little significant impact. Its activities have been limited mainly to the provision of advice and the organisation of training.

5. It is considered that if there is to be a significant number of redundancies, then additional measures will need to be taken. It will be necessary to provide a means of co-ordinating existing Departmental schemes and applying them to the particular situation. The exact detail of the measures will depend on the numbers made redundant and the local circumstances at the time. In developing measures it will be necessary to widen the effort to regenerate the local economy beyond those areas and individuals primarily affected.

6. A brief description of the measures being considered is:-

(a) Enterprise Company: It is proposed to relaunch HWEL as Queen's Island Enterprises and its initial activity will be to take over the counselling and advice service currently being provided by HWEL. In addition to liaison with Job Markets and guidance on retraining, it is proposed that Queen's Island Enterprises should offer advice and assistance for those wishing to start their own businesses. In carrying out its activities, QIE will be

encouraged to build on the skills and facilities which exist within H & W and which might be retained as free standing businesses. It is intended that QIE will be managed by the private sector and although initially requiring public sector funding it will be encouraged to seek private sector capital.

(b) Action for Community Employment (ACE) jobs: In 1987/88 the Department of Economic Development sponsored an average of 6200 ACE jobs. The ACE scheme has now a proven and positive track record and has enabled participants to provide a worthwhile contribution to the community whilst at the same time gaining valuable experience. In terms of job/years the net cost to the exchequer is low. An aim of providing an additional 2000 ACE jobs each year over a period of 5 years has been set.

(c) Development Corporation: There are already plans to establish a Development Corporation to be known as Laganside Corporation to develop an area of land fronting on the River Lagan and adjacent to the Queen's Island site. It is proposed to extend the remit of Laganside Corporation to include the Queen's Island site and to develop the site following an initial land use survey. The Queen's Island site is very central, has good road links, and has access to deep water berths and the Harbour Airport. Its facilities are, however, geared towards shipbuilding and it will be necessary to undertake substantial infrastructure development in redeveloping the site. It is expected that this redevelopment will include the erection of new factory accommodation although this might be built elsewhere in the city.

(d) Enterprise Zone: The existing Belfast Enterprise Zone covers a substantial area of North and West Belfast and it is proposed to extend the zone to cover the Queen's Island site.

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(e) Other Measures: Other measures include the establishment of an additional Action Team which will operate in the East Belfast area. The large number of redundancies which is envisaged will almost certainly require the provision of extra funds for existing schemes to meet the likely demand upon them. This could require the provision of additional resources for retraining, the Local Enterprise Development Unit and Enterprise Allowance Grants etc.

Cost

7. Attached is an estimate of the cost of these measures over the next five years.

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HARLAND AND WOLFF

ESTIMATES OF COST OF REMEDIAL MEASURES

	<u>1988/89</u>	<u>1988/90</u>	<u>1990/91</u>	<u>1991/92</u>	<u>1992/93</u>	<u>TOTAL</u>
	£M	£M	£M	£M	£M	£M
Local Enterprise Co.	2.0	2.0	2.0	2.0	2.0	10.0
400 extra LEDU Ent. Grant projects	0.5	0.3	0.6	0.6		2.0
Laganside Corporation				14.0	14.0	28.0
Belfast Action Team	0.5	0.5	0.5			1.5
2000 ACE jobs		9.3	9.3	9.3	9.3	37.2
1200 people retrained	0.3	0.2	0.4	0.4		1.4
400 Enterprise Allowance Scheme places	0.2	0.1	0.3	0.3		0.8
Factory Costs						
- Factory space at £40 per sq ft			2.0	4.0	2.0	8.0
- Associated Landscaping			1.0	1.0		2.0
- Infrastructure development			1.5	1.5		3.0
<hr/>						
TOTAL ESTIMATED COST OF REMEDIAL MEASURES	3.5	12.5	17.6	33.1	27.3	94.0

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Treasury Chambers, Parliament Street, SW1P 3AG  
01-270 3000

PRIME MINISTER

### SHIPBUILDING

The Chancellor of the Duchy's paper on the future of shipbuilding circulated on 28 March 1988 set out proposals for measures to alleviate the effects of redundancies in shipbuilding, on top of those measures promoting development and employment already available, which might be introduced in support of a decision for closure of NESL. These involve, in addition to counselling and retraining, enterprise promotion measures and a major new programme of factory building in the North East. He also supports Nicholas Ridley's proposal for an Enterprise Zone in Sunderland.

I understand that Malcolm Rifkind is also likely to propose a substantial package of measures for Scotland, again with a very large element of factory building. This would be in addition to the Enterprise Zone in Inverclyde already agreed.

I am very concerned about the public expenditure costs of the measures now being proposed for England and Scotland. We are agreed that closure should be accompanied by some package of special measures. But these should be proportionate to the problem. While the absolute number of redundancies which would be precipitated by the closure of NESL and the sale of Govan to Kvaerner is serious, it is a good deal less than has happened in other industries in recent years. Moreover, it will occur against the background of rapidly declining levels of unemployment generally. Given the continued economic recovery, the effect of closure on Sunderland, where the vast





bulk of the total redundancies would be concentrated, is no more than a temporary hesitation in the rate of decline in unemployment. The same would be true of the Glasgow Travel to Work Area, even were Govan to close.

Against this background the possible packages proposed for England and Scotland appear to me excessive. If the costs of the recent offer of assistance to Nissan and of the proposed Enterprise Zone for Sunderland are included, the proposals involve public expenditure of some £86m to generate some 5,000 jobs in England in response to some 3,000 job losses from shipbuilding. Similarly, including the new Enterprise Zone agreed for Inverclyde, they could involve public expenditure of around £71m in Scotland to generate about 6,000 jobs in response to some 1,300 job losses from shipbuilding. In total they could amount to expenditure of at least £157m (excluding any additional costs for counselling and training in Scotland, or any extension to the Inverclyde EZ). This would amount to over £36,000 for each shipbuilding job lost, more than double the cost per job limit for regional assistance in Development Areas.

On Harland and Wolff, while Tom King will be putting forward substantial proposals for remedial measures, I understand he has already accepted that further work by officials will be needed in the light of decisions on British Shipbuilders. I would very much hope that we could then agree something more modest than the £94m outlined in his paper.

Any package of remedial measures must also take into account the availability of resources to fund them. Closure will not lead to early savings of public expenditure for shipbuilding support which could then be used to fund remedial measures. I must, therefore, look to the Secretaries of State most affected for funding from within their existing provisions.



Whatever is done should be even-handed between the territories. Agreement to the Enterprise Zone at Inverclyde was on the basis of no additional provision, and I would in particular expect the same to apply to any Enterprise Zone for Sunderland, including any associated costs of regional assistance.

Whatever is done by way of remedial measures, I am quite clear that we must end Government subsidies to UK merchant shipbuilding at the earliest opportunity, and that it would be wholly counterproductive to try to safeguard jobs in shipbuilding areas by continuing and entrenching current support arrangements. Merchant shipbuilding in Europe is, and will remain for some years, an uneconomic activity. Even at the peak of the next shipbuilding cycle it is highly doubtful that UK yards could be competitive. In terms of job support, the costs of shipbuilding subsidies are indefensibly poor value for money.

I therefore entirely agree with Kenneth that the alternative to disposal of Govan must be its closure, and that we must not contemplate disposal on terms involving continuing subsidies. Closure of NESL seems inevitable, and I would support an early statement to that effect. We will need to discuss at your meeting whether there should be an early comprehensive announcement covering Govan and Harland and Wolff. But I am clear that it would be indefensible to maintain subsidies in Scotland and Northern Ireland, where the same arguments should apply with equal force.

I am copying this minute to David Young, Kenneth Clarke, Malcolm Rifkind, Tom King, and, in view of the reference to a possible Enterprise Zone for Sunderland, Nick Ridley and to Sir Robin Butler.

*N.L.*

[N.L.]

30 March 1988



30/3/88  
 [Handwritten signature]

CC-CST.  
 FST.  
 Sir P Middleton  
 Mr Anson  
 Mr Mowbray  
 Mr Moore  
 Mr Burgess  
 Ms Seaman  
 Mr Walker  
 Mrs Brown  
 Mr A White  
 Mr Guy  
 Mr Sharratt  
 Mr Williams  
 Mr Call  
 Mr Rutnam

Treasury Chambers, Parliament Street, SW1P 3AG  
 01-270 3000

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A handwritten signature, possibly 'N.L.', in dark ink.

[N.L.]

30 March 1988

*Papers pse.*  
*House*

FROM: A M WHITE  
DATE: 30 MARCH 1988

CHIEF SECRETARY

cc Chancellor  
Financial Chief Secretary  
PMG  
EST  
Sir Peter Middleton  
Mr Anson  
Mr Philips  
Mr Monck  
Miss Peirson  
Mr Burgner  
Miss Noble  
Mrs Brown  
Mr Waller  
Mr Call

*Ch/ Addressed to CST in FST's absence.  
As he was not at meeting he  
would like to make sure  
you are content (decision  
needed tomorrow).*

*mpw*  
*30/3*

JAMES MACKIE & SONS LTD

The outcome of the E(A) discussion on Mr King's proposal to rescue James Mackie was that public ownership was precluded but that in consultation with the Chancellor and Lord Young, an alternative rescue vehicle should be sought with the Bank of England's help. Furthermore, E(A) did not wish to take a final decision on Mackies until there had been a further discussion of the positions of Harland & Wolff and Shorts. In the meantime, Mr King should take the measures necessary to prevent Mackies immediate collapse.

2. We have now had a preliminary discussion with Bank of England officials. Their normal role in company rescue attempts is, at the instigation of a bank or government department, to bring the creditors together and through the application of the principle of equal misery, to see if receivership can be avoided. Although the request to help James Mackie is out of the normal run, they will make contact with potential private sector investors to investigate the possibilities of assisting the company.

3. Before they can do this, we need to advise them on the level of government assistance that might be forthcoming. If you agree, we would like them to be a position to say that the Treasury does not rule out some support or perhaps the injection of some funds into the company although we would want that contribution

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minimised and that there can be no question of taking the company into public ownership.

4. In view of the company's financial position, Bank officials will have to work quickly and we would like to confirm to them tomorrow our view on the limits of Government assistance they should assume. I would be grateful for your agreement to this.



A M WHITE

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## Inland Revenue

Policy Division  
Somerset House

30 March 1988

1. MISS RHODES *AR 30/3*
2. PS/CHANCELLOR OF THE EXCHEQUER *X/6/7/1*  
(MR TAYLOR)

## MERCHANT SHIPPING BILL: COMMITTEE STAGE: MERCHANT NAVY RESERVE

1. I have seen a copy of the letter from Jill Thatcher (PS/Minister for Public Transport) to you of 23 March. She drew your attention to the question raised by Barry Field MP, during Committee, about the taxability of the proposed bounty payment to members of the Merchant Navy Reserve (MNR). You might appreciate this short note about the position.

2. Essentially, it is proposed that a MNR be established to provide a pool of qualified and experienced seafarers who could be drawn upon in a time of national emergency. In return for holding themselves in readiness to serve, it is intended that members of the MNR should receive an annual bounty. A figure of £200 has been mentioned. The appropriate enabling powers are provided in Clauses 27 and 28 of the Merchant Shipping Bill.

3. We first became aware of this proposed bounty following a PQ laid by Mr Field after Committee. The question and answer is attached.

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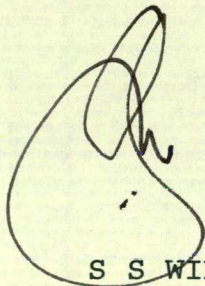
cc	PS/Chief Secretary	Mr Isaac
	PS/Financial Secretary	Mr Lewis
	Sir Peter Middleton	Miss Rhodes
	Sir Geoffrey Littler	Mr Fraser
	Mr Anson	Mr Wilcox
	Mr Scholar	PS/IR
	Mrs Case	
	Mr Culpin	
	Miss Sinclair	
	Mr McIntyre	



4. DTp have since provided us with more background about the reserve and bounty. In the light of this, we have advised DTp that - like members of the Royal Navy Reserve and TAVR - MNR members would be employees within the scope of Schedule E. Since any bounty paid for carrying out the prescribed duties of a reservist would be an emolument, it would be taxable under the Schedule E rules.

5. We have also explained to DTp that a special tax exemption (of some 40 years standing) exists for those bounty payments received by members of the reserve and auxiliary forces of the Crown in return for attaining a recognised level of training and efficiency.

6. It was not the original intention that the duties of MNR members should have any training component - at least in the beginning - and on that basis this exemption would not be available. However, DTp and MoD are looking at this possibility again. If it is decided that MNR members should similarly have a training obligation, then any bounty primarily linked to training could be paid tax-free. We are keeping in touch with DTp over developments.

A handwritten signature in black ink, consisting of a large, stylized initial 'S' followed by a smaller 'S' and the name 'WILCOX'.

S S WILCOX

PQ 487/87

PARLIAMENTARY DEBATES OF  
(DAILY REPORTS) 3. 3. 88  
VOL. 128 NO. 107 COL. 627

**Merchant Navy Reserve (Bounty)**

**Mr. Barry Field :** To ask the Chancellor of the Exchequer if the new bounty proposed for the Merchant Navy Reserve is to be treated in the same way as the bounty paid to the Territorial Army and be free of tax.

**Mr. Norman Lamont:** The tax position of the proposed bounty for members of the Merchant Navy Reserve cannot be settled until the precise obligations of reservists, which give rise to the payment, have been established. I understand these are currently under detailed consideration.

SECRET



10 DOWNING STREET  
LONDON SW1A 2AA

8/4

CH/EXCHEQUER

05 APR 1988

Mrs Braon

COPIES TO

CST, FST, 50 PM, Middleton  
 Mr Anson, Mr Monck  
 Mr Moore, Mr Buzynov  
 Ms Seaman, Mr Waller  
 Mr A White, Mr Evans  
 Mr Guy, Mr Sharatt  
 Mr N Williams

31 March 1988

Mr Rutnam  
Mr Call

From the Private Secretary

Dear Peter,

SHIPBUILDING

The Prime Minister held a further meeting this morning to discuss shipbuilding. Those present were the Chancellor of the Exchequer, the Secretary of State for Northern Ireland, the Secretary of State for Trade and Industry, the Chancellor of the Duchy of Lancaster, the Secretary of State for Scotland, the Parliamentary Under-Secretary of State for Defence Procurement, Ministry of Defence, Sir Robin Butler, and Mr. Richard Wilson and Mr. George Monger (Cabinet Office). The meeting had before it minutes dated 29 March from the Chancellor of the Duchy of Lancaster and 30 March from the Secretary of State for Northern Ireland.

Govan and negotiations with Kvaerners

The Chancellor of the Duchy of Lancaster said that negotiations were now under way with Kvaerners for the purchase by them of the Govan yard. The negotiators needed definite instructions as to the line they should take. The main question to be decided was whether Kvaerners should have access to Intervention Fund support. They had asked for such support at the maximum rate of 28% for orders for three ships during this year, at a cost of £35 million, and after that for the same support as was available for other UK yards. His view was that it was dangerous to offer continuing support from the Intervention Fund. He would prefer to offer an initial cash provision, or dowry, which could be up to £75 million, the savings which would be made by not having to close the yard. But he had to warn that refusal to provide Intervention Fund assistance could lead to the failure of the negotiations.

In discussion the following points were made:

- a. It was clearly better not to promise continuing Intervention Fund support. But collapse of these very promising negotiations because it was refused might not be easy to explain publicly, especially since such support was available elsewhere in the Community. The Government could however point out that it had offered the dowry of up to £75 million.
- b. The United Kingdom must maintain a minimum strategic capability to construct merchant ships. But if it was

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necessary for strategic reasons, the warshipbuilding yards - which were not eligible for Intervention Fund assistance - could always construct such ships, with funding coming from the Defence budget.

c. While yards remained in the public sector, the Government incurred costs both through the losses made by the nationalised industry and through the Intervention Fund. When they were transferred to the private sector then at least no more costs would be incurred for the first reason even if Intervention Fund support continued.

d. Intervention Fund support where shipbuilders sold to associated companies, as Kvaerners and Mr. Tikkoo would, was open to abuse since its size would depend on prices which might not be arm's length.

e. It was not clear that a dowry of £75 million to Kvaerners genuinely represented net additional funds for them, given the liabilities they would inherit on taking over the yard.

The Prime Minister, summing up this part of the discussion, said that the group agreed that negotiations with Kvaerners should continue with the objectives of transferring Govan to the private sector and bringing Intervention Fund support to an end. The negotiators should endeavour to achieve both objectives in the agreement with Kvaerners, via a dowry of up to £25 million. But as between the two objectives, that of transferring Govan to the private sector had priority. In the last resort, continued Intervention Fund assistance was not ruled out if it was necessary to reach agreement with Kvaerners. Further consideration would need to be given to the precise terms of such an arrangement; if it had to be conceded, the dowry payment, if any at all were needed in those circumstances, should be reduced to a minimum. It would also be necessary to ensure that the support was based on prices determined on an arm's length basis.

#### Sunderland

The Chancellor of the Duchy of Lancaster said that Mr. Johanssen, the entrepreneur who had placed the order for the Danish ferries, was in default. A formal notice to that effect would be sent to him very shortly, and he would be given two weeks to make good his default. If he failed, the whole question of the future of the Sunderland yards would be precipitated. The process would become public, and the Government could be forced into a statement as early as the week of 11 April. This statement could say that the yards would close following the completion of a given number of ferries. An announcement of closure must be accompanied by the announcement of a convincing package of remedial measures for the Sunderland area.

In discussion the following main points were made:

a. There was no doubt that the Sunderland yards would have to close. The question was whether it would be better for them first to complete and then sell some of the ferries being

built for Mr. Johanssen. Calculations by the Department of Trade and Industry suggested that this could be cheaper than immediate closure. These calculations would however have to be carefully scrutinised with the Treasury.

b. The package of remedial measures proposed in the minute by the Chancellor of the Duchy of Lancaster was politically necessary for the presentation of the closure. They also represented a good bargain for the Government, since if the yards were kept open substantially greater costs would be incurred in subsidies. On the other hand, it was argued that the Government had also decided to assist the Nissan project with a view to helping with the consequences of closure of the yards; and that an Enterprise Zone (EZ) had been proposed for Sunderland with the same object in view, and would incur substantial costs also. The creation of an EZ also weakened the case for public expenditure on advanced factories. The package now proposed was excessive if account was taken of these other measures.

The Prime Minister summing up this part of the discussion said that it was clear that the Sunderland yards would have to close, and that an early announcement might be necessary. The suggestion that it would be cheaper for them first to complete some of the ships being built for Mr. Johanssen was at first sight surprising and would need to be discussed further by the Chancellor of the Exchequer and the Chancellor of the Duchy of Lancaster. As to remedial measures, the group endorsed the proposal for an EZ at Sunderland. This made it unnecessary for public spending on advanced factories other than the £7.6 million proposed for 1988-89. Subject to the deletion of expenditure on advanced factories after that date, the package of remedial measures proposed by the Chancellor of the Duchy of Lancaster was agreed.

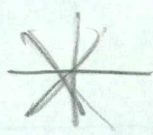
#### Other yards in Great Britain

Summing up a brief discussion the Prime Minister said that negotiations should continue for the sale of the Appledore yard at Bideford to a private sector consortium. Subject to the progress with Govan, the Appledore negotiations might be on the basis that Intervention Fund support would be available. Closure of the Hall Russell yard seemed inevitable. The Ferguson yard at Greenock would have to close when the current Caledonian MacBrayne order was completed, but it was agreed that any announcement to that effect would be unwise, and prejudice the reception of the EZ at Greenock. It was better for the yard to be left to reduce its activities gradually as work on the order was completed; in the meantime the yard should not be allowed to take on new orders.

#### Harland & Wolff

The Secretary of State for Northern Ireland said that Harland & Wolff (H&W) was now negotiating with Mr. Ravi Tikko for an order for a very large cruise liner. The project was an interesting one. The liner would represent a major extension of cruising to a cheaper market. West European yards were more competitive with far Eastern yards in building cruise liners than in other sectors and H&W, with perhaps one

other, was the only yard in Europe capable of building such a vessel. Despite this, he continued to have grave doubts about H&W's performance and prospects and indeed thought it likely, though he could not be sure at present, that they would have to close. But he was certain that the prospect of an order from Mr. Tikkoo must be examined seriously, and be seen to be so examined. He was also interested in the possibility that Mr. Tikkoo, perhaps in combination with the management and workforce, would take over the yard. All such possibilities should be considered bearing in mind the need for consistency of treatment between H&W and yards in Great Britain. While they were being pursued it would be wrong to make any announcement about the future of the yard. Meantime he would discuss the scale and financing of a package of remedial measures with the Treasury.

The Prime Minister, summing up a brief discussion, said that the group saw very strong objections to placing more orders with H&W. But they recognised the need, given the political difficulties in Northern Ireland, to be seen to be considering all possibilities. They were therefore content for negotiations to continue with Mr. Tikkoo, in particular about a possible transfer of the yard to the private sector. 

I am sending copies of this letter to the Private Secretaries of the Ministers at the meeting, and to the others present.

Yours,



(PAUL GRAY)

Peter Smith, Esq.,  
Office of the Chancellor of the Duchy of Lancaster

CONFIDENTIAL



A handwritten signature in dark ink, appearing to be "M.P. Wallace".

FROM: MISS M P WALLACE

DATE: 31 March 1988

MR A M WHITE

cc Chief Secretary  
Financial Secretary  
Paymaster General  
Economic Secretary  
Sir P Middleton  
Mr Anson  
Mr Philips  
Mr Monck  
Miss Peirson  
Mr Burgner  
Miss Noble  
Mrs Brown  
Mr Waller  
Mr Call

**JAMES MACKIE & SONS LTD**

This is to confirm that, as I told you on the phone this morning, the Chancellor saw your minute of 30 March, and was content with the line you propose to take in discussing the company's position with the Bank.

A handwritten signature in dark ink, appearing to be "M.P.W.".

MOIRA WALLACE

SECRET



10 DOWNING STREET  
LONDON SW1A 2AA

94

EXCHEQUER	
REC.	06 APR 1988
ACTION	Mrs Brown
COPIES TO	GST, FST, Sir P Middleton Mr Anson, Mr Mack Mr Moore, Mr Swynor Ms Secombe, Mr Collier Mr A White, Mr Evans Mr Guy, Mr Shortall Mr Putnam, Mr N. Williams Mr Call

From the Private Secretary

5 April 1988

Dear Peter,

**SHIPBUILDING**

It has been pointed out to me that the gremlins have got to one of the figures given in my letter of 31 March. In the middle paragraph on page 2, the figure of £25m. should have read £75m. I should be grateful if you could arrange for this amendment to be made.

I am sending copies of this letter to Alex Allan (HM Treasury), David Watkins (Northern Ireland Office), Alison Brimelow (Department of Trade and Industry), David Crawley (Scottish Office), Hugh Kernohan (Ministry of Defence) and Trevor Woolley (Cabinet Office).

Yours,  
Paul

Paul Gray

Peter Smith, Esq.,  
Chancellor of the Duchy of Lancaster's Office.

SECRET





mp

Treasury Chambers, Parliament Street, SW1P 3AG  
01-270 3000

6 April 1988

Paul Gray, Esq  
No.10 Downing Street  
London SW1

CC, CST  
FST  
PMG  
EST  
Sir P MIDDLETON  
Mr SCHOLAIR  
Mrs CASE  
Mr REVOLTA  
Miss SINCLAIR  
Mr AR WILLIAMS  
Mr COOPER  
Mr FRIE  
Mr CALL

CHAIRMAN  
Mr ISAAC  
Mr PAINTER  
Mr MCGUEN  
Mr LEWIS  
Miss RHODES  
Mr FRASER  
Mr I STEWART  
Mr K ALLEN  
PS/IR

Dear Paul

**SHIPPING: TAXATION OF SEAFARERS**

At the Prime Minister's meeting on 23 February the Chancellor was asked to provide advice on the PAYE/Isle of Man problem and on the personal taxation of seafarers.

... I attach a note by the Chancellor on these matters.

I am copying this letter and enclosure to Tony Galsworthy (Foreign and Commonwealth Office), Brian Hawtin (Ministry of Defence), Alison Brimelow (DTI), Geoffrey Podger (DHSS), Roy Griffins (Department of Transport), Peter Smith (Chancellor of the Duchy of Lancaster's office), Richard Wilson and George Monger (Cabinet Office).

Yours,

Moir

MOIRA WALLACE  
Private Secretary



## TAXATION OF SEAFARERS

### Note by the Chancellor of the Exchequer

At our meeting on 23 February I was asked for papers on the PAYE/Isle of Man problem and on the personal taxation of seafarers.

This note looks at the present position, and possible changes to assist with crewing costs. My conclusion is that tax changes would not offer a sensible solution to the problem of uncompetitive British crewing costs on ships which we wish to retain on the British register for defence reasons.

#### PAYE and the Isle of Man agencies

Until a few years ago, most shipping companies employed their crews directly and operated PAYE like other UK employers. Over the last few years many have stopped employing the crews on their ships and instead engaged them through overseas agencies. The crew then have their contracts of employment with the agencies and are paid by them. The shipping companies are not operating PAYE for crews engaged in this way.

The point at issue between the Revenue and the shipping companies is whether they are still required to operate PAYE when they engage their crews through offshore agencies. The law makes special provision for circumstances in which an employee of one person works for another. Where that second person has "general control and management" of the work done, he is liable to operate PAYE, even though the worker concerned is not his own employee and is not paid by him.



So the question the Inland Revenue have been considering is whether the shipping companies have the "general control and management" of the work done by the crews of their ships. The circumstances vary in detail, and, of course, the Revenue have not yet obtained information on every case. But the general picture emerging is that the shipping companies do have the control and management of the work of the crews on their ships, and the Revenue's legal advice is that the shipping companies should be operating PAYE.

Because of our discussions, the Revenue have not yet given their views to the shipping companies. The shipping companies would, of course, have an opportunity to persuade the Revenue that their views are mistaken, initially through discussions and, if they wished, through appeals to the Appeal Commissioners and, ultimately, to the Courts.

The question of whether or not the shipping companies should be operating PAYE ought not to be a big issue for them. PAYE is an administrative arrangement for collecting the crew's UK income tax liability. It does not affect the amount of the tax for which they are liable, and the tax paid to the Revenue is not an additional cost for the shipping company. There are, of course, some administrative costs; but the system has been much simplified recently, and the cash flow benefits of retaining the tax before paying it over to the Revenue mean that there is often little or no financial cost for the employer.

While the operation of PAYE should thus be a matter of relative indifference to the shipping companies, it is important for the Revenue. Deduction at source is self-evidently a more efficient and effective way of collecting tax than looking to each individual seaman to settle his own tax liability. And the Revenue cannot collect the liability directly from the seamen if the shipping companies ought to be operating PAYE. In any event, the Revenue



has to apply the law to the shipping companies in the same way as it is applied to all other employers.

I can see no conceivable basis on which I would be justified in picking out shipping companies for a special exemption from PAYE obligations. Everyone would know that that would be little help to them, unless the assumption was that they would be able to negotiate lower wages on the footing that their crews would, in one way or another, avoid paying any UK income tax on their pay. We would thus implicitly be encouraging and condoning that situation. In any event, it would make no sense to maintain the tax charge on UK seamen while depriving the Revenue of the administrative arrangements necessary for collecting the liability. And since PAYE is simply a collection mechanism, it would be impossible to justify exempting shipping companies from its requirements and not others in similar situations. Many UK companies, particularly those operating in such areas as financial services, oil and computers, are currently operating PAYE in respect of individuals working for them in the UK but still employed and paid by their foreign employers. And it would not be particularly difficult for other employers to transfer their employment function to an offshore company and to seek, by analogy with the shipping industry, to remove any PAYE obligation. Even if we abandoned PAYE and the seamen thus achieved a de facto exemption, that might not be sufficient, particularly in the longer term, to bridge the gap between UK wage levels and those of competent third world crews.

But while I believe the PAYE position must be maintained, I recognise that starting tax deductions again could in certain circumstances increase the shipping companies' difficulties. The fact of the matter is that some seafarers - perhaps the majority of those concerned - have recently been receiving their earnings tax free. To the extent that shipping companies have already negotiated wage rates on this basis which are lower than they would



otherwise have been, starting PAYE again would put upward pressure on pay costs. I have, therefore, considered whether there is any solution in reducing the tax liabilities of UK seafarers.

### Taxation of Seafarers

The taxation of seafarers, like other people, turns mainly on two considerations

- whether the seafarer is resident in the UK for tax purposes
- whether he performs his duties in the United Kingdom or overseas.

A non-resident seaman is only liable for tax on earnings in the United Kingdom. But if the seafarer is resident in the UK - and most UK seamen will be because they have their homes here and spend a fair amount of time in this country - he will be liable to UK tax on all his earnings, whether the duties are performed in the UK or overseas.

There is, however, a special tax relief which, although it was not introduced with seamen in mind, can provide a substantial benefit for UK resident seamen who work overseas for long periods. The 100% foreign earnings deduction is given where a seaman spends a period of 365 or more days overseas with not more than 62 consecutive days in the UK.

Because of the diverse and quickly changing pattern of shipping - and the cessation of PAYE in many cases - the Revenue do not have a clear picture of the aggregate tax liabilities of UK seamen employed in the deep sea trades which are most exposed to foreign competition. The GCBS have recently quoted a figure of £70 million for the tax liabilities of British seamen on UK



registered ships. Of those employed in the deep sea trades, some will be exempt because they are non-resident and some - possibly an increasing number because the shipping companies are said to be planning seamen's work in that way - will qualify for the 100% foreign earnings deduction. But under the present rules it is probably the case that at least as many are due to pay tax in the UK as are exempt.

### Possible Changes

I have considered two possible ways in which the liabilities of seafarers might be reduced with a view to reducing, indirectly, the crew costs of British ships - an exemption for particular classes of seafarers, or an extension of the present reliefs for people working predominantly abroad, either through the residence rules or the 100% foreign earnings deduction.

### An Exemption for Seamen

This looks extremely unattractive as a matter of tax policy.

We would need to define the particular types of seamen - or rather particular types of voyage whose earnings would be exempt. There is clearly no point in exempting people - such as seamen on ferries - for whom there is no defence problem.

Such an exemption would be unique. It could not be justified on the grounds that a seafarer's taxable capacity was less than that of someone else with the same income. It would thus be considered unfair, both by those seamen who did not qualify (and whose importance in defence terms might be just as great) and by other taxpayers generally. It would lie very awkwardly with the taxation of Royal Navy personnel, who are chargeable on all their pay however long they serve abroad.



It would also be clearly contrary to the general thrust of our tax policy which has been to reduce tax rates while broadening the tax base by removing or restricting special exemptions and reliefs wherever possible.

Nor, in any event, do I think this would be effective in tackling the problem of crew costs.

- Some of the relief would inevitably go to UK seamen serving on foreign-registered ships which might not be available, or available only to a limited extent, to the UK in an emergency.
- Of the relief going to the ships we wish to help, almost certainly the full cost of the tax relief would not be reflected in reduced crewing costs because that would be a matter of negotiation between ship owners and seamen. (The GCBS have pointed to the amount of income tax seamen pay, but they have not argued for an exemption as such apparently because they recognise that some mechanism would be needed to ensure that the benefit accrued to the shipping companies if it were to be of any help in reducing their costs. They have not suggested any such mechanism).
- You cannot easily vary the amount of a tax exemption to give the amount of assistance required; and as tax rates fall an exemption becomes less valuable (as the charities are always telling us).

My conclusion is that a tax exemption for seamen would not only be unattractive but would be inefficient as a method of assisting shipping companies with crewing costs.



## Residence rules and the 100% foreign earnings deduction

The argument for easing these rules would be that more seamen would benefit from them and their increased net pay would enable the shipping companies to pay lower wages.

In terms of tax policy and general effectiveness this approach seems to suffer from much the same disadvantages as a special exemption. It would in fact represent a reversal of previous policy, since in 1984 we were able to withdraw some highly unsatisfactory special reliefs for people working overseas in the light of the tax reductions previously made. It would look extremely odd to be increasing the scope of tax shelters shortly after a Budget containing large tax reductions.

The residence rules and the 100% foreign earnings deduction apply to everyone, so if they were changed the benefit would go far wider than the seamen we want to help. But if relaxations were targeted on seamen, that would be seen as unfair by the others who at present qualify.

This approach would probably be even less effective than a direct exemption for seamen because we would simply be redrawing the boundaries of a tax relief and - even with generous relaxations - some seamen would continue to fall the wrong side of the dividing line. Another big disadvantage is that no-one can be sure he is entitled to relief until he has spent the necessary time abroad. For both these reasons it would be very unlikely that the possibility of increased tax reliefs for the seamen would be fully reflected in reduced wages.





## Conclusion

My clear conclusion is that there are very strong arguments against either changing the PAYE rules or granting seafarers special tax reliefs. Moreover, since they operate very indirectly on crew costs, and could not be confined precisely to the type of vessel we want to help, they would be likely to be bad value for money. I thus see no sensible role for taxation changes in achieving our objectives.

*N.L.*

[N.L.]  
30 March 1988

*BF to Jonathan*  
*7/4*



FROM: MOIRA WALLACE  
DATE: 6 April 1988

*[Handwritten signature]*

MR WILCOX - INLAND REVENUE

cc PS/Inland Revenue  
Miss Rhodes - IR

**MERCHANT SHIPPING BILL: COMMITTEE STAGE: MERCHANT NAVY RESERVE**

The Chancellor has seen and noted your minute of 30 March to Mr Taylor.

*[Handwritten signature]*

MOIRA WALLACE



Treasury Chambers, Parliament Street, SW1P 3AG  
01-270 3000

7 April 1988

Paul Gray Esq  
10 Downing Street  
LONDON SW1

*Dear Paul*

**SHIPBUILDING**

... I attach a copy of a minute from the Chancellor to the Prime Minister, dated 30 March. I very much regret that this was not circulated earlier, owing to an administrative error.

I am copying this letter and enclosure to Stephen Ratcliffe (DTI), Peter Smith (DTI), David Crawley (Scottish Office), Martin Donnelly (NIO), Deborah Lamb (Environment) and Trevor Woolley.

*Yours sincerely*

*Jonathan Taylor*

J M G TAYLOR  
Private Secretary

SECRET

FROM: W GUY

DATE: 8 April 1988

- 1. MRS BROWN
- 2. CHANCELLOR

*I consider it essential to insist on a 'break point' in the negotiations for selling Govan shipyard. We are in danger of exacerbating continued support for all merchant shipbuilding.*  
MEB sl4.

- cc
- Chief Secretary
  - Financial Secretary
  - Sir P Middleton
  - Mr Anson
  - Mr Monck
  - Mr Moore
  - Mr Burgner
  - Mr Waller
  - Mr A W White
  - Mr N Williams
  - Mr Rutnam
  - Mr Cropper
  - Mr Call
  - Mr Tyrie

*Contact is proposed as suggested by White, who is ~~convinced~~ with the ~~provision~~ of no ~~pen's~~ ~~autg.~~*

SHIPBUILDING

This submission seeks your clearance of action at official level which we believe is necessary to protect our position following the Prime Minister's meeting.

2. There are two issues; first, the tactics for negotiation with Kvaerner on disposal of Govan and second, the source of the finance which will be necessary for a possible dowry to Kvaerner and for remedial employment measures. On the second point, this submission includes a section provided by IAE.

Negotiating with Kvaerner

3. DTI officials say that whilst it is inconceivable that Mr Clarke would give final approval to a deal disposing of Govan before consulting colleagues, they are not required by the spirit of the No 10 meeting to consult us in advance of a final deal being shaped up. This makes us very uneasy.

4. It was agreed at the Prime Minister's meeting that:

- (i) If possible, Kvaerner should be offered an up-front dowry of no more than £75 million;

SECRET

(ii) continued Intervention Fund (IF) assistance was not ruled out in the last resort - but in that case a dowry should be kept to a minimum;

(iii) further consideration would need to be given to the precise terms of any IF arrangement.

5. We do not want DTI to rush headlong to a deal involving continuing Intervention Fund support at Govan (before the No 10 meeting our view was that we would rather see the yard close than concede open-ended IF as the price of a disposal). Moreover, we cannot be sure what Kvaerner mean by "continuing IF support". You will recall that they have asked provisionally for guaranteed support on three ships (worth £35 million) and thereafter the same support terms as other UK yards and the right to discuss with Government any move to support levels below prevailing EC maxima. But the only bit of this which would be bankable, as it stands, is £35 million. They must want more than this, and they are therefore likely to produce some fine print.

6. The risk is that not only would the Govan disposal foul prospects for removing IF, but it could actually positively entrench IF. This is a dangerous prospect. We therefore propose to write formally to DTI at official level saying that:

(i) before the negotiations move from up-front dowry to continuing support, there should be a statement from Kvaerner of why continuing support is essential and a pause to consider it;

(ii) there should also be a pause (which might well be one and the same) for Ministers <sup>to consider</sup> exactly what Kvaerner had in mind, in detail, for continuing support; the implications of this (including those for Harland's with the Tikoo order, and private yards); and to agree the precise arrangements which DTI could put to Kvaerner.

7. Our position would we believe be fully consistent with the record of decisions from the No 10 meeting. But as DTI

officials interpret their remit differently, you will wish to comment before we proceed.

### Finance

8. We understand that the discussion on 31 March did not address the issue of how any support to Kaeverner or the remedial measures agreed for the North East in the event of closure of NSEL might be financed. The latter aspect was covered in your minute to the Prime Minister of 30 March, which stated that agreement to any Enterprise Zone in Sunderland must be on the basis of no additional provision and that you would look to the Secretaries of State most affected for funding towards other measures from within their existing provisions. However this was not received by colleagues until after the meeting.

9. DTI officials have subsequently made clear that the Chancellor of the Duchy's proposals were on the basis that all additional funding needs would be met by the Exchequer and in particular that any 'dowry' to Kaeverner within the £75 million agreed at the meeting on 31 March would not require any DTI contribution. We believe this to be unreasonable. Whilst we accept that it will not be possible for DTI and Scottish Office to fund the full cost of what is now proposed we would look to both for a significant contribution. Unless you feel that the terms of the discussion on 31 March rule this out and subject to the views of the Chief Secretary we would therefore propose making clear to DTI and Scottish Office officials in discussing possible sources and mechanisms of support that:

(i) we will be looking for a significant contribution from DTI (as proposer of the package, with responsibility for Shipbuilding) and the Scottish Office (as benefiting from the jobs saved) towards the cost of any dowry to Kvaerner;

SECRET

(ii) we will additionally be looking for a significant contribution from DTI towards the cost of counselling, retraining, enterprise promotion and factory building measures in England;

(iii) No additional provision for an Enterprise Zone in Sunderland.

10. Once the amounts and mechanisms of support are clearer we will submit further advice on the detailed division of costs which might be proposed to colleagues, but would envisage a package involving equal contributions from DTI, Scottish Office and the Exchequer to the cost of any dowry (ie up to £25 million each), and equal contributions from DTI and the Exchequer to the cost of the remedial measures in England excluding the EZ (ie up to £12 million each).

11. It would be helpful to know urgently that you are content.

*W GUY*

W GUY



*JMG*

FROM: J M G TAYLOR

DATE: 11 April 1988

MR GUY

cc PS/Chief Secretary  
PS/Financial Secretary  
Sir P Middleton  
Mr Anson  
Mr Monck  
Mr Moore  
Mr Burgner  
Mrs Brown  
Mr Waller  
Mr A W White  
Mr N Williams  
Mr Rutnam  
Mr Cropper  
Mr Call  
Mr Tyrie

**SHIPBUILDING**

The Chancellor has seen your minute of 8 April.

2. He is content to proceed as you suggest, which is consistent with his interpretation of the provisional outcome of the Prime Minister's meeting.

*JMG*

J M G TAYLOR



SECRET


 SCOTTISH OFFICE  
 WHITEHALL, LONDON SW1A 2AU

 Paul Gray Esq  
 10 Downing Street  
 LONDON  
 SW1A 2AA

CH/EXCHEQUER ✓ 14/4	
REC.	14 APR 1988
ACTION	MRS BROWN
COPIES TO	CST, EST SIR P MIDDLETON MR ANSON, MR MONCK MR MOORE, MR BURGNER MS SEAMEN, MR WALLER MR ALWHITE, MR P EVANS MR GUY, MR SHARRATT MR WILLIAMS, MR RUTNAM MR CALL

14 April 1988

*Dear Paul,*
**SHIPBUILDING**

My Secretary of State has asked me to comment on one point in your record of the meeting of 31 March.

In relation to the Ferguson yard at Greenock, my Secretary of State had understood the group to have agreed that it should not be allowed to take on new orders on any basis other than that which is available to other yards in the UK ie which would meet the restrictions on Intervention Fund support which would apply generally. Clearly this will make it relatively unlikely that any new orders would be forthcoming but to place a prohibition on any new orders would become publicly known and would have the same effect as an announcement of closure, which the group agreed would be unwise particularly in the context of the new Enterprise Zone and other measures being taken in Inverclyde. The end result may well be the same, but will be achieved with less potential for disruption at the yard or of the Government's wider efforts in Inverclyde. In the meantime, the yard could be in a position to secure an order for a small ferry for Mauritius for which no support would be required other than an aid package which has already been offered, if Ferguson's, which is the only UK yard in contention, wins the contract.

Copies of this letter go to the recipients of yours.

*Yours sincerely,*  
*David Crawley*  
 DAVID CRAWLEY  
 Private Secretary

SECRET



Inland Revenue

Policy Division  
Somerset House

*Thank. IR offers this week*

FROM: P LEWIS  
DATE: 14 APRIL 1988

- 1. CHAIRMAN
- 2. FINANCIAL SECRETARY

*I think this reads very nicely. The Chancellor also expressed an interest in seeing the transcript; a copy has gone to Mr. Allan.*

**SHIPPING: EVIDENCE TO THE TRANSPORT SELECT COMMITTEE**

- 1. You may like to see the uncorrected proof of the evidence given by officials to the Transport Select Committee on 22 March.
- 2. The Committee raised some questions on PAYE and the taxation of seafarers. But most time was spent on investment incentives, and as you will see there were persistent attempts to get officials to disclose advice given to Ministers on the possibility of special reliefs for the shipping industry.

*Lisa Miles*

*for* P LEWIS

- cc PS/Chancellor
- Mr Scholar
- Mrs Case
- Miss Sinclair

- Chairman
- Mr Isaac
- Mr Painter
- Mr McGivern
- Mr Lewis
- PS/IR

FROM: M SHARRATT  
DATE: 15 APRIL 1988

- 1. MISS PEIRSON
- 2. FINANCIAL SECRETARY

- cc Chancellor
- Chief Secretary
- PMG
- EST
- Sir Peter Middleton
- Mr Anson
- Mr Philips
- Mr Monck
- Miss Peirson
- Mr Burgner
- Miss Noble
- Mrs Brown
- Mr Waller
- Mr White or
- Mr Call

*Handwritten notes in red ink:*  
 If New is →  
 use package @ all,  
 a completely ~~different~~ new  
 dynamic way  
 to run.

JAMES MACKIE & SONS LTD

Following the discussion in E(A) on 29 March, Bank of England officials have explored the possibility of 3i's involvement in a rescue of James Mackie. The executive committee of 3i, which includes the Chairman, Deputy Chairman and Chief Executive, have considered the proposition and have declined to get involved, nor do they believe that other private sector investment could be attracted at this stage.

2. This confirms what Lazards, Rothschilds and Coopers and Lybrand had all previously advised and effectively ends the immediate search for a private sector led rescue. Consequently, Mr King will be returning to colleagues very shortly with an alternative to his original rescue plan (which you will recall, involved taking the company into full public ownership). The revised plan is based on a suggestion from the Bank and while it would avoid formal public ownership, it would mean that Government would have to put up all the cash for the first £6 million tranche and almost certainly the bulk of the subsequent tranches of £8 million and £6 million over years 2 to 5 of the plan.

3. The first tranche of £6 million would involve the Industrial Development Board (IDB) subscribing for £1 million of new ordinary shares and £2.5 million of non-voting preference shares. The balance of £2.5 million would be in the form of capital grants<sup>from IDB</sup>. At

the same time, the Northern Bank would convert £1 million of its overdraft into new ordinary shares and would secure <sup>(not call in)</sup> the remaining balance of its debt. The present owners would retain the third £1 million block of ordinary shares. Subsequent IDB funding would be in the form of capital grants and a further preference shares holding.

4. The only advantage of the revised plan is that it avoids formal public ownership although it still commits government to providing all the cash required. But if the company is to be rescued it seems very unlikely that there is any other way forward.

5. Rescue of the company cannot be justified on commercial grounds and the decision will have to rest on the political arguments. If these point to the plan being approved, there are two features in particular which will need to be fully articulated before the go-ahead should be given. First, given the considerable injection of public funds that the plan entails, effective control must rest with IDB and the mechanisms whereby control is exercised will need to be sufficient to do this - de Lorean should never be far from our minds. Second, the company's management needs to be immediately and considerably strengthened. The weakness of the existing management was identified by the Bank <sup>and 3i</sup> as one of the main obstacles to an injection of private capital into the company, and confidence in the management and its plans is clearly a sine qua non for future private investment and the ultimate return of the company to the private sector.

6. These points have been made to Northern Ireland officials and we would expect them to be covered in Mr King's further memorandum. We will provide briefing on this when it arrives.

*M Sharratt*

M SHARRATT

To:

PRIME MINISTER

From:

KENNETH CLARKE

84

CH/EXCHEQUE	
REC.	18 APR 1988
ACTION	MRS BROWN
COPIES TO	CST, FST
	SURP MIDDLETON
	MR ANSON, MR MONCK
	MR D MOORE, MR BURGNER
	MS SCAMMAN, MR WALLER
	MR AM WHITE, MR P EVANS
	MR GUY MR SHARRATT

18 April 1988

ck  
 CST was involved  
 in discussions on  
 this. Announcement  
 was made this afternoon  
 AA

MR RUTMAN, MR N WILLIAMS  
 MR CALL

## SHIPBUILDING

Following your meeting on 31 March, my officials and British Shipbuilders have continued their negotiations with Kvaerner Industries, the Norwegian company interested in acquiring Govan. Negotiations have reached the point where I expect Kvaerner to present BS today with a letter of intent to purchase, subject to their reaching a satisfactory settlement with their workforce and acceptable terms of transfer, including support from us. I am very glad to say they have confirmed their willingness to negotiate on the basis of a dowry, the very strong preference expressed by colleagues at your meeting. I have congratulated my officials responsible for the face-to-face negotiations for their success in achieving this conclusion, which I strongly

preferred, without having to fall back on the final position that we authorised.

2. Kvaerner insisted that they would not be able to sign an agreement, even with variations, without a satisfactory agreement with the workforce, including the prospect of a reduction from 1,800 to 1,300 employees to improve competitiveness, and for far less generous lay-off terms than BS agreed nationally some years ago. They are also now acutely nervous of the latest leak, which has emanated from Oslo, prejudicing the confidence of the workforce in the yard's management, which Kvaerner would take with them. Given the importance of providing other bidders with a possible chance to identify themselves, I have decided that I must make a clear announcement today (Monday) about the privatisation possibilities now facing BS and in particular about the possible disposal of Govan.

3. This will put very great pressure on us to make a clear statement about the future of the remaining yards and, in particular, NESL in Sunderland. On 31 March I reported the contractual difficulties that have arisen with Johansen, the Danish financier behind the programme of 24 small ferries now being built at Sunderland. As agreed at your meeting, BS gave notice of defaults under the building contract for a number of ships. While there are certainly technical grounds for counterclaim by the Danes, Johansen has made clear he will be amenable to suggestions of curtailment.

The upshot is that a combination of contractual strife and negotiations could bring the programme to an end later this year.

4. These kinds of difficulty, the continuing costs of BS, and the lack of economic orders explain very graphically my conviction that subsidised shipbuilding in state-owned yards should cease as soon as present orders are complete. This is underlined by the independent survey from Peat Marwick I mentioned in my minute of 29 March, which showed that there would be sufficient capacity to absorb the peak in world shipbuilding demand widely expected in the 1990's in such a way that there was no prospect of lasting viability for BS without continuing support. The BS Board have endorsed my conclusion on viability. I believe that colleagues shared my conviction at the meeting you held but the discussion proceeded on the basis that we should announce this when the Danish purchaser defaulted.

5. I therefore now propose that my statement should also say that we have decided that there should be no more support for new orders in BS yards, nor should any more loss making orders be taken. This is against the background of orders regularly running at a loss over the past few years, despite assurances from BS that they would not.

6. I attach a draft of my Statement. I could only make the full Statement if my disagreement with Nigel Lawson about

who should pay for cost-avoiding dowries and remedial measures is accepted by him. I find his arguments totally inconsistent with the basis upon which we reached agreement at your meeting.

7. I also think it is very important that Tom King should make a thoroughly uncompromising Statement about the prospects for Harland and Wolff in due course. I strongly believe shipbuilding on both sides of the Irish channel should be treated similarly whenever announcements are made. If Harlands were to stay open other than as a privatised yard, the task of the Chairman of British Shipbuilders would become much more difficult, and we might face resignations. I cannot see how I could explain a different policy in Wearside to one in Ulster on the subject of the financial treatment of shipbuilding. I fully recognise the appalling and very special difficulties that Tom King faces in Northern Ireland but I do not think that they would be accepted as an explanation in North East England.

8. I believe the arguments for an early comprehensive Statement about merchant shipbuilding in Great Britain are strong. Delay would also risk losing the initiative in Parliament, since the Shipbuilding Unions are preparing a mass lobby for the second half of May, and their friends are to press for a Debate in the expectation of decisions around June or July. Tom King is obviously facing the beginnings



of an intensive public relations campaign in favour of the cruiseship which will build up very quickly.

9. On more technical grounds, my draft Statement refers to legislation and includes a phrase to reassure those from whom BS might borrow in the months ahead. This is because Treasury officials have advised that BS can no longer use Public Dividend Capital given the clear intent behind my proposed Statement, and that access to grant under the Consolidated Funds Act 1932 requires procedures in Parliament, possibly in July, before such monies can be made available.

10. My hopes for the disposal of Govan and Appledore by means of dowry will require EC approval. My officials have meetings arranged in Brussels for Friday and I shall be speaking today to Peter Sutherland. The more restructuring they can point to, especially in terms of an announcement withdrawing support from BS yards, the more likely is the Commission to accept whatever we need to do to achieve those disposals. The radical nature of the announcement I propose could also help David Young on Rover and to secure the Commission's agreement to our proposals for Enterprise Zones in Inverclyde and Sunderland.

11. I invite my colleagues to agree that I should make a comprehensive Statement on the lines of the attached draft text.

12. I am sending copies of this minute to Nigel Lawson, David Young, Malcolm Rifkind, Tom King, Nicholas Ridley and to Sir Robin Butler.

A handwritten signature in black ink, appearing to be 'L.' with a flourish underneath.

KC

CONFIDENTIAL



FROM: MISS M P WALLACE

DATE: 18 April 1988

PS/FINANCIAL SECRETARY

cc PS/Chief Secretary  
PS/Paymaster General  
PS/Economic Secretary  
Sir P Middleton  
Mr Anson  
Mr Phillips  
Mr Monck  
Miss Peirson  
Mr Burgner  
Miss Noble  
Mrs Brown  
Mr Waller  
Mr Sharratt  
Mr White o/r  
Mr Call

**JAMES MACKIE & SONS LTD**

The Chancellor has seen Mr Sharratt's minute of 15 April. He has commented that if there is any rescue package at all, a completely new management will be required.

  
MOIRA WALLACE

SECRET

CH/EXCHEQUER, 19/4	
REC.	19 APR 1988
ADON	MRS BROWN
COPIES TO	CST, FST, SIR P MIDDLETON
	MR ANSON
	MR MONCK, MRD MOORE
	MR BURGNER
	MS SEAMMEN, MR WALLER
	MR A M WHITE
MR R EVANS, MR GUY	
MR SHARRATT, MR RUTMAN	



10 DOWNING STREET  
LONDON SW1A 2AA

CHIEF SECRETARY	
REC.	19 APR 1988
	CX

From the Private Secretary

18 April 1988

MR N WILLIAMS, MR CALL

SHIPBUILDING

The Prime Minister held a meeting earlier this afternoon to discuss the Chancellor of the Duchy's minute of today's date and the attached draft statement. Those present were, the Secretaries of State for Northern Ireland, the Environment, Trade and Industry, the Chancellor of the Duchy of Lancaster, the Secretary of State for Scotland, the Chief Secretary, George Guise (Policy Unit) and Richard Wilson (Cabinet Office).

After a brief discussion it was agreed that the Chancellor of the Duchy should make the much briefer statement which he subsequently delivered to the House this afternoon. It was also agreed that the Chancellor of the Duchy should prepare a further paper setting out his proposals for the outstanding issues in the near future.

I am copying this letter to the Private Secretaries to the Secretaries of State for Northern Ireland, the Environment, Trade and Industry, the Secretary of State for Scotland, the Chief Secretary and to Sir Robin Butler.

PAUL GRAY

Peter Smith, Esq.,  
Chancellor of the Duchy of Lancaster's Office.

SECRET

The Rt. Hon. Kenneth Clarke QC MP  
Chancellor of the Duchy of Lancaster and  
Minister of Trade and Industry

Rt Hon Nigel Lawson MP  
Chancellor of the Exchequer  
HM Treasury  
Parliament Street  
LONDON  
SW1P 3AG

Department of  
Trade and Industry

1-19 Victoria Street  
London SW1H 0ET

Switchboard  
01-215 7877

Telex 8811074/5 DTHQ G  
Fax 01-222 2629

K8/4

CH/EXCHEQUER	
REC.	18 APR 1988
ACTION	MRS BEAON
COPIES TO	CST, FST, Mr P Middleton Mr Anson, Mr Mowck Mr D Moore, Mr Bwyner Mr Seaman, Mr Walker Mr A White, Mr R Evans Mr Guy, Mr Stratatt

*Ch*  
This should be  
attached as background  
to the 'Shipbuilders' papers  
which you are raising  
with Mr Clarke at  
Cabinet this am

Mr Rutman Mr N Williams  
Mr Call

*This is who relevant  
Kramer pr with who I will  
be speaking for C. But it  
is clear essential that  
CST starts to  
work*

*26 21/4*

*The Prod.*

Direct line 215 5147  
Our ref  
Your ref  
Date 18 April 1988

### BRITISH SHIPBUILDERS

I was surprised to see from your Private Secretary's letter of 7 April circulating your minute of 30 March that you were seeking Departmental contributions to the cost of special measures to deal with the effect of BS. I have made it clear on every occasion since the issue was first raised that these merited extra expenditure as part of the price for withdrawing from continued support for shipbuilding.

I had, however, assumed that your minute of 30 March had been circulated primarily for the record since you did not raise the question at the meeting on 31 March. I was, however, astonished to hear from my officials that yours had told them on Thursday that not only were you seeking Departmental contributions to the cost of special measures, but that you were now also expecting contributions to the closure and sale costs of British Shipbuilders. This runs if anything even more strongly counter to the thrust of our position on the need in your words "to grasp the nettle of the cost of BS closure".

*The mtg. in your  
knows. closed because a  
PM ran on of time before  
this question was  
then @ no time did M-C  
make a claim on  
No Answer.  
M.*

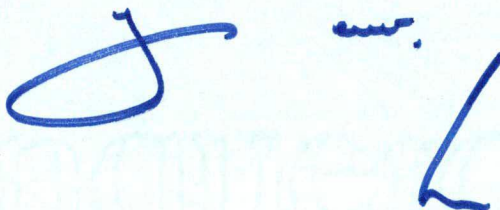
AP2ABN

*ask for materials, AMSP, the  
you. of no contribution  
make both costs of BS-  
related special measures.  
BTI*

The formal position in the Public Expenditure White Paper is of course that BS had an EFL of £80m for 1988/89 - its previous baseline which we agreed to leave in place for the time being. John Major, in his letter of 4 September, recognised that "a substantial aggregate increase above the baseline cannot be avoided". The preliminary figures for the cost of closure were set out in my paper of 20 October.

I hope therefore that I can proceed on the lines agreed at the Prime Minister's meeting, on the assumption that the extra costs above BS's artificially low EFL will be borne by the reserve, as will the costs of the agreed special measures.

I am copying this letter to the Prime Minister, David Young, Malcolm Rifkind, Tom King, and Nicholas Ridley, and to Sir Robin Butler.



KENNETH CLARKE

AP2ABN



Present  
on to  
Mr Williams

\* What is the pos. in X?  
(p3)

No. 2 reformation  
para 19, I do not  
agree (iv) but with  
para to (iii) rather, to  
M.

19/4/88

19/4

*On some heavy stuff  
2. default / expense  
bids*



CH/EXCHEQUE	
REC.	19 APR 1988
ACTION	MR A. WILLIAMS
COPIES TO	PSCST P/ST SIR P. MIDDLETON SIR G. LITTLE M. WREN MR SCHWABER MR PHILLIPS MR SCASE MISS PETERSON MR ROBSON MR CURPIN MR BARKLEY MR S. M. SPAIN MR SCAMMEN MISS S. CLAIRE MR MCINTYRE MR BOSTON MR FRASER I/R

Prime Minister

*Ch. To see. We shall be getting  
comprehensive briefing for the meeting.*

*20/4*

**MERCHANT SHIPPING AND DEFENCE**

Following our meeting on 23 February about the potential demand for merchant shipping in an emergency and war, five papers have been prepared:

- (I) George Younger and I have analysed specific merchant shipping requirements;
- (II) I have drawn up a note on offshore manning contracts;
- (III) I have contributed a paper on the response of other countries to the decline of their fleets, and
- (IV) another on access to merchant ships in crisis and war;
- (V) Nigel Lawson has provided a paper on the taxation of seafarers and the PAYE problem.

Nigel Lawson's paper (V) was circulated on 6 April. I am enclosing the remaining papers (I)-(IV) with this minute.

2. It may help to focus our next discussion, on 4 May, if I now attempt to draw the threads together.

**Strategic Needs**

3. Enough ships are available at present to provide direct support for the Royal Navy and the Army, though the supply of product tankers may become critical if shipowners move away from





offshore registers (a threat because of the PAYE problem - see para 9) or if the vessels are not replaced as they are scrapped. If war broke out, however, there are likely to be shortages for other purposes in at least three categories of vessel - product tankers, container ships and larger general cargo vessels (Annex D to the paper (I) on Merchant Shipping Requirements in Emergency and War). The NATO pool is most unlikely to be able to supply enough product tankers to enable our essential fuel demands to be met in wartime. The shortfall in container and break-bulk general cargo vessels for transatlantic reinforcement is due in part to the shrinking of the UK fleet. In wartime there would also be a shortage of vessels for the importation of foodstuffs and other essential commodities not shipped in bulk, and this would be exacerbated if hostilities broke out before transatlantic reinforcement was complete. If hostile action resulted in the loss of container facilities at the major ports, there would be a requirement for larger numbers of general cargo vessels which could certainly not be met from either our own or NATO resources.

4. These calculations take fully into account all the opportunities for getting hold of UK-owned vessels operating on foreign registers. We are examining the possibility of obtaining further ships on the assumption that foreign owners would be tempted by the prospect of profits, backed up by the UK's War Risks Reinsurance Agreements, to charter their ships to the UK. But it would be unwise to rely on much assistance from this source, since these ships would be in neither British nor NATO countries' beneficial ownership; and the foreign owners concerned might, for geopolitical reasons, be unwilling or unable to commit themselves to the UK at an early stage of a war.

5. I have reviewed what others have done. The Americans have been giving general operating subsidies to liner companies for



40 years in order to maintain a minimum fleet for strategic purposes. They also maintain a substantial mothballed fleet. In 1986 the cost to the US Government of operating subsidies was \$288 million, while the cost of the Ready Reserve fleet was \$363 million including \$217 million for acquisitions. Elsewhere, the strategic role of the merchant marine tends not to be recognised overtly, but many countries assist their fleets for a variety of reasons, usually to maintain employment in a traditional industry or as a by-product of help to shipbuilding. Investment grants or tax allowances are probably still the most important method of assistance.

#### Assistance with Crew Costs

6. Although at present there is a problem over re-investment, the largest single factor in the competitiveness of British shipping and that of all the traditional maritime countries, is the cost of crewing. Increasingly, Western European countries are turning to offshore registries to help their owners stay in shipping while avoiding the high costs associated with the employment of their own nationals. The strategic implications of this increasing dependence on foreign crews are only just now beginning to be appreciated. In some European countries the trend - likely to be reflected in proposals from the Commission - is towards relieving owners of at least some of the extra cost of employing EEC nationals, probably through tax or social security concessions. Norway, Sweden, Denmark, Netherlands and Greece have all moved very firmly in this direction; though primarily, we believe, for commercial rather than defence reasons.

7. Our own policy, in the absence of any significant investment incentives or special concessions for UK seafarers, has been to work for open shipping markets and to rely on the freedom of owners to flag out to convenient British (Crown Dependency and



Dependent Territory) offshore registers, in the hope that the attractions of British flag registers will be sufficient to keep the necessary ships available. By moving from the UK register owners have managed to make significant savings by negotiating new contracts of employment with their existing employees. When the Merchant Shipping Bill receives Royal Assent we shall be able to give our shipowners some modest help with training and crew travel costs, but the budget for these is limited to £8.5m in the first full year.

8. Doubts about the longer-term effectiveness of this policy flow from:

- (i) the possibility that the application of PAYE (and in some cases employers' NICs) to UK resident seafarers employed by overseas manning agencies will, by seriously reducing the attractiveness of these arrangements, lead to ships being reflagged further away with non-British crews;
- (ii) the fact that, regardless of the flag under which they operate or the crew which they use, British shipowners, except those in the passenger sector, have not since 1984 found the business sufficiently profitable to renew more than a negligible part of their investment.

9. What can we do about these threats? When the Revenue give their decision to require PAYE deductions, there may of course be an appeal which could delay the reaction. The Revenue may be able to offer an administrative simplification in respect of those seafarers entitled to Foreign Earnings Deduction. But there must be a risk that several owners may switch - particularly away from the Isle of Man - to more attractive foreign registers. This is potentially serious since, to take



product tankers which is one of the categories where we foresee a shortage, there are 73 vessels on the Isle of Man/Dependent Territories Registers out of a British flag total of 140.

10. In my view, the most effective ways of reducing the risk of this flight from our offshore registers would be first, for the Revenue not to seek retrospective collection of tax prior to the start of this financial year; secondly, to announce that we are studying ways of reducing the impact of personal tax and social security obligations on UK seafarers employed by British shipping companies in certain trades at least.

11. Just as we cannot insulate ourselves from world-wide trends in personal taxation generally, so we cannot ignore what other countries are doing in this field if a UK-manned fleet is to remain competitive. Tax and NIC payments can amount to as much as 19% of total crew costs - about 4% of total costs - on a product tanker, though the foreign earnings deduction will reduce the tax liability for some seamen.

12. I recognise that Nigel Lawson and John Moore will find it difficult to accept concessions of this sort and also that to announce such a review would raise expectations which might in the end have to be disappointed. I also understand that the Revenue feel that with the new tax year now starting they must very shortly contact the shipping companies about PAYE, and that the shipping companies also are anxious for an early decision. Whatever decision may be made on a review I do hope that, at the very least, the Revenue will not seek retrospective reduction of tax from previous tax years.

#### Investment

13. At our previous meeting it was agreed that we should try to target any assistance to the vessels that were likely to be in



particularly short supply. I therefore consider the three areas of shortage - product tankers, container ships and larger general cargo vessels - separately.

14. On container ships, since I first drew attention to the lack of investment two months ago, P & O have ordered one large container vessel for operation on the UK register. While this is an encouraging development, it is too early to say whether it signals a general improvement in the climate for investment, and will not of itself make much of an impact on the problem of transatlantic sealift. I propose keeping developments in this sector under close review. The arrangements I propose below for product tankers will need to take account of the possible need to apply them to container ships later.

15. Break-bulk (general cargo) ships are steadily disappearing as more modern, efficient container ships take over. But shipping patterns will change in wartime for a number of reasons. Present indications are that we would have a shortage of 600-800 general cargo ships and we can never hope to have enough of these in British ownership to satisfy the war-time demand. This will inevitably be a difficult area to deal with, because of the large number of vessels involved and because they are now more common in the Third World than in the North Atlantic. There is no single answer and I do not suggest trying to secure more of these ships in peace-time. I am, therefore, looking at other ways of helping meet the demand. For example, there may be a certain limited scope for making arrangements with friendly states to charter them quickly in emergency or war, or for paying owners of the smaller container ships to install special gear. It would also be helpful if the containerisation of military supplies could be increased.

16. The third area, which I believe does demand immediate action, is product tankers. Here we expect to be between 40 and



80 ships short of meeting a potential demand for nearly 200 in the range 10,000 - 40,000 dwt. These estimates do not fully reflect the reductions in demand that might result from rationing, but neither do they take account of possible losses through enemy action. On the best evidence we have available, this is a vessel category in which a serious general shortage is likely to emerge in wartime. The consultant advising the NATO Study has said that there is no likelihood of the NATO pool being able to supply sufficient product tankers to enable UK essential fuel demand in wartime to be met since there are only just enough tankers to meet Europe's peacetime requirements. More tankers would be needed in wartime to ship crude oil and product to compensate for the capacity reduction which would result from the loss of North Sea oil and loss of production from European refineries because of enemy action.

17. I believe that we need to take action to ensure the availability of this type of vessel, and I propose that we devise a scheme for this purpose. This could take the form of compensation payments for operation under the British flag of between £50,000 and £250,000 annually per vessel, depending mainly on how many of the crew were British. However, I propose to minimise the cost by a competitive tendering arrangement under which UK owners would contract with us to retain a given number of specified tanker types under the British flag with suitable crews (perhaps a full complement of British officers). This would in effect reflect the extra crewing costs beyond what was commercially justifiable but the element of competition would make the costs payable by Government as low as possible. The scheme would have to apply to all vessels that we need in the specified categories, not merely to the number by which we fall short of the target. If we have to pay an average cost of say £100,000 per vessel the annual cost for 200 product tankers would be £20m, but the actual cost would depend on the results of the competition. Further work will need to be done by officials on such a scheme and primary legislation will be



required. I believe that a scheme of this sort would guarantee the product tankers needed in wartime and that it could, if necessary, be extended to other types of vessels later.

## CONCLUSION

18. Over the last three years, we have considered collectively or bilaterally with the Treasury a number of options for helping the British shipping industry to compete more effectively and thereby help to meet our strategic needs. These have included

- special front-ended depreciation allowances
- roll-over relief of balancing charges
- an investment grant targetted to short-sea vessels
- an 'Emergency Availability Premium' for deep-sea vessels, designed to encourage the use of Dependent Territory Registers.

None of these schemes has found favour with colleagues. We cannot go on rejecting ideas for dealing with the problem for ever.

## RECOMMENDATIONS

19. I hope that we can agree that:-

- (i) urgent action is needed to ensure that we can meet the wartime shipping requirements as set out in the paper prepared by George Younger and me;
- (ii) reinforcing the measures we are adopting in the Merchant Shipping Bill, we should take every opport-



- unity we can of reducing the extra cost to owners of employing British crews;
- (iii) the Inland Revenue should not seek retrospection beyond the start of this financial year and should look for administrative means of reducing the impact of PAYE;
  - (iv) the case for alleviating the personal tax and social security burden on the industry should be further examined;
  - (v) I should work up a scheme for a contract with owners of vessels in short supply to secure their availability in war;
  - (vi) I should be prepared to announce that we are considering these further measures, to mitigate the likely reaction to the communication by the Inland Revenue of their decision on PAYE;
  - (vii) the position on other types of ship should be kept under review and that I should continue to examine alternative ways of satisfying the wartime demand for break-bulk ships, including the containerisation of NATO's Transatlantic reinforcement requirements.

20. I am copying this minute and the papers to Nigel Lawson, Geoffrey Howe, Douglas Hurd, George Younger, John Moore, David Young and Sir Robin Butler.

PC

PAUL CHANNON  
19 April 1988



MERCHANT SHIPPING REQUIREMENTS IN EMERGENCY AND WAR

Note by the Secretary of State for Defence and the Secretary of State for Transport

INTRODUCTION

1. At the meeting on 23 February the Prime Minister asked for a further paper on the supply of the particular types of merchant shipping which cause the greatest concern. This paper covers the supply of ships to meet the 3 main tasks.

- a. the direct support of the UK armed forces;
- b. the UK contribution to transatlantic reinforcement (which includes US Military Sealift, also referred to as the Rapid Reinforcement Plan);
- c. civil supply of the UK from overseas

These tasks are examined separately but it should be noted that they draw to some extent on the same types of ships: particularly with regard to product tankers and general cargo vessels, meeting the demands of one task is possible only at the expense of the others.

DIRECT SUPPORT OF THE UK ARMED FORCES

2. Direct support of the UK armed forces is a UK national responsibility. A table showing the UK military requirement is at Annex A. With one exception the requirement can currently be fulfilled by ships on British registries: and within that, mainly by ships on the mainland UK, Isle of Man, Channel Islands and Bermuda registers. As such they will generally be manned by British or Commonwealth officers and in many cases British ratings, who will continue to serve in war. Some crew changes may be necessary where non-NATO seafarers are employed, but this will depend on the nature of the operation assigned to the vessel, the crew's willingness to serve, and the attitudes of their governments. (Throughout the paper 'availability' refers to the number of vessels of a particular type which can be presented at a specified port within the required timescale. It does not however take account of the time needed for any necessary modifications for naval or military roles.

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3. Only one requirement cannot be met from the British fleet. There is cause for concern, however, in the supply of several types of ship for military requirements: either on grounds of total numbers, or their availability in sufficient quantity within a reasonable timescale. In more detail, by ship type, the issues are:

- a. Fishing vessels and North Sea Support Vessels for a variety of naval tasks. Most requirements are well covered, though for some specialised roles - submarine support, forward repair, and MCM command and support - the number of ships which closely approach the specifications is very limited. Number required 8, now 10 or fewer available on the British registry. Future vessel availability is related to activity levels in the UK offshore oil industry. Similar ships may be available for purchase, or charter from European NATO allies.
- b. Product tankers to support RN operations at sea, on convoy duties, and for harbour support. Because vessels in the most useful size range (15-60,000 dwt) trade widely around the world there will be difficulty in acquiring product tankers of this size in sufficient numbers to meet the planned phased naval requirement for some vessels at an early stage (within 7 days) and the remainder within 30 days. In order to ensure their availability at the required locations within this timescale very early notice will have to be given of the total number needed in transition to war or war itself. The final naval requirement is for 38 product tankers of all sizes: the supply on the British register worldwide of 101 is considered just sufficient to meet the demand within the required timescale. A recent trend has been for product tankers on the UK registry to transfer to the Isle of Man and Bermuda, which is likely to reduce the number of UK nationals in their crews, and may be a preliminary step towards foreign flagging. Total product tanker numbers are insufficient to meet the full requirement for naval support and civil resupply. (Annex D).

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- c. Cruise ships to transport troops from the UK to Norway and to return casualties. Requirement 2 within 5 days, 1 within 10 days: number available 2 within 5 days plus 2 within 10 days. (RoRos could also be used, though at the cost of a reduction in the lift capacity from UK to the Central Region).
- d. RoRo ferries for the UK armed forces reinforcement of the Central Region, mainly within the first 10 days; for the UK/NL ATG to Norway; and a small number for naval tasks (eg minelaying). Total requirement 69, number available 74. Numbers currently in service are sufficient to cope with the peak reinforcement demand over 4 or 5 days in the worst case situation now foreseen, when the maximum number of reinforcement plans would be running concurrently: but with very little margin for civil requirements or complicating circumstances. The effect of the Channel Tunnel and stricter safety standards may be to reduce the size and capacity of the RoRo ferry fleet below the requirement in the early/mid 1990s. However, conclusion of Host Nation Support agreements with Belgium, Germany and the Netherlands over use of their modern RoRo ferry fleets would provide an ample cushion of over-capacity to meet the Central Region reinforcement requirement into the foreseeable future, but no negotiations have been initiated.
- e. Heavy Lift Ship requirement 1, none available. A relatively new requirement for the joint Royal Marine/Royal Netherlands Marine force deployment to N Norway, this could not have been met in the past from UK assets and cannot now. No British shipowners possess suitable vessels. Negotiations are taking place with the Netherlands to obtain a suitable vessel to support the joint force within the required (5 day) timescale.

UK CONTRIBUTION TO TRANSATLANTIC REINFORCEMENT

4. The Rapid Reinforcement Plan (RRP) is a vital element in NATO's strategy of deterrence, and would ideally be completed before the outbreak of war: though that could not be guaranteed. The Pentagon has estimated that 600 large fast dry cargo ships from the total NATO pool need to be earmarked in order to ensure the availability of the 400 needed for RRP. The figure of 400 makes no allowances for attrition or other losses. The RRP requirement is likely to rise to about 450 as a result of a

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US review to be issued by the summer. The number of suitable ships has declined steadily over the past 5 years (Annex B). In September 1985, 574 were earmarked, of which 124 were British registered. Two years later the number earmarked had fallen to 448 of which 94 were British. A particular concern is the world-wide commercial trend towards containers and away from break bulk general cargo ships, the type most suited to handling much of the military equipment which cannot easily be containerised. The trend is illustrated at Annex C.

5. Although provision of shipping for transatlantic reinforcement is a shared NATO responsibility the UK has historically played a major role. While the UK share of the total number of ships earmarked has remained stable at around 21%, since 1982 the UK contribution of containerships for Sealift has fallen from 52 (31%) to 41 (21%). Over the next 10 years replacement or reinvestment decisions will have to be taken on the entire UK/IOM/Bermuda registered large containership fleet of 41 ships.

CIVIL RESUPPLY OF THE UK

6. It is clear that even in the early days of a war, because of the needs of the armed forces and the Rapid Reinforcement Plan, there would be shortages of general cargo vessels and product tankers. The extent of the shortfall is difficult to quantify, as it would depend on:

- a. progress on transatlantic reinforcement, and the other demands of military resupply;
- b. availability of Hong Kong registered shipping in particular beyond 1997, and the general availability for requisitioning of British owned foreign registered shipping;
- c. continued availability of non-British owned shipping for civil resupply;
- d. success in mustering adequate crews (even taking into account the proposed Merchant Navy Reserve) to man British Dependent Territory or foreign registered ships which were not British officered.

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7. The table at Annex D shows the heaviest demand for shipping, with both the Rapid Reinforcement Plan and civil resupply running concurrently. Taking both the worst case (reliance on British flagged ships only, and excluding Hong Kong registered ships) and the best case (British flagged ships including Hong Kong, plus UK owned but foreign flagged ships), substantial deficits would arise in the 3 critical categories:

	Best (British flag incl HK and flagged out)	Worst (British Flag excl HK)
product tankers (10-40,000 dwt)	- 39	- 81
general cargo (above 5,000 dwt)	- 478	- 534
containerships	- 34	- 63

On the more favourable assumption that Rapid Reinforcement had been completed before the outbreak of hostilities, demand would ease slightly but deficits would remain:

	Best	Worst
product tankers (10-40,000 dwt)	- 39	- 81
general cargo (above 5,000 dwt)	- 435	- 494
containerships	+ 7	- 22

8. Figures for civil demand are inevitably less precise than for military requirements, but are the best estimates made by civil departments in 1985 of the numbers of ships, based on typical ship loads by commodity, required to transport the volumes of imports judged essential to the economy of the UK in wartime. The figures take account of the effects of some switching to more distant sources of supply, and cessation of exporting. The figures for essential imports compare with the average ship arrivals in Britain per month in 1986:

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	1986 monthly average arrivals ship nos	essential imports ship nos employed
container, under 5000 dwt	130	
general cargo, under 5000 dwt	3641	
dry bulk and general cargo over 5000 dwt	634	601
container, over 5000 dwt	178	63

9. The NATO shipping pool will help the situation regarding both ships and crews, but in view of the contraction of the pool in recent years there can be no expectation of surpluses from NATO allies making up these shortfalls to provide for civil supply of the UK. A clearer picture of total NATO demand and supply of shipping will emerge when the NATO study reports in 1989/90.

CONCLUSIONS

10. A number of general conclusions can be drawn:

a. the requirements of the UK armed forces can be met at present almost entirely from ships on the UK mainland, Isle of Man, Channel Island and Bermuda registers, though the supply of certain types of ships is limited and could worsen in the near future. The following provisos apply:

- i. heavy lift ship - MoD agreement with the Netherlands
- ii. RoRos - numbers are just adequate to meet the worst-case peak requirement. Conclusion of MoD Host Nation Support agreements with Belgium, the Netherlands and Germany would assure ample supply.
- iii. North Sea supply vessels - numbers of some specialised types are just adequate to meet RN support requirements. If UK offshore oil activity declines numbers are likely to fall. Vessels could probably be purchased or chartered from European NATO allies.
- iv. Product tankers - availability rather than total numbers is the problem. To ensure timely provision the whole requirement would have to be declared at a very early stage in TTW.

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b. Provision of both container and break bulk dry cargo shipping for US Military Sealift (RRP) will become more difficult as NATO merchant fleets decline and the industry continues to switch away from break bulk ships. Position will worsen unless US military switch from break bulk cargo vessel requirement, and as RRP cargo volumes increase.

c. The same categories of ships - container and break bulk general cargo - as well as product tankers will be in short supply both nationally and within the NATO pool, to meet civil supply requirements.

d. With the decline in NATO allies' national fleets and reductions in the numbers of seafarers from the high cost North American and West European countries manning of requisitioned shipping with loyal and reliable crews is a growing problem.

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MERCHANT VESSEL REQUIREMENTS FOR MILITARY REINFORCEMENT  
AND SUPPORT OF RN OPERATIONS

TYPE OF VESSEL	ROLE	REQ'T	REMARKS
<u>Large Stern Trawler</u>	Minesweeper	4	Requirement was for 20. Balance made up by North Sea support vessels
<u>Other Fishing Vessels and offshore supply vessels</u>			
Offshore supply or anchor handler	Balance of minesweepers	16	
Fishing, standby or supply vessel	Danlayer	17	
Large fishing or supply vessel	Administrative escort	31	
Comercial survey vessel	Survey ship	6	
Rig maintenance or diving support	Submarine support ship	1	
Rig maintenance or diving support	Forward repair ship	5	
Rig maintenance or diving support	MCM command and support ship	2	
<u>Product Tankers</u>			
Self propelled barge/tanker	Clyde river tanker	2	
Coastal tanker 2,000-4,000 dwt	Harbour tanker	11	
Product tanker 4,000-15,000 dwt	Amphibious support tanker	4	
Product tanker 15,000-60,000 dwt	Freighting tanker	4	
Product tanker 15,000-60,000 dwt	Convoy escort oiler	7	
Product tanker 15,000-60,000 dwt	Auxiliary support tanker	12	



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Break Bulk General Cargo

(Mostly shortsea trading. earmarked for Sealift not included)	Vessels	Support of JTPs	50	Will support JLPs later.
		Survival stores carrier	3	Small cellular container vessel could be used for moving TEUs
		Armament carrier	4	

Large Passenger Ships

	Troop/hospital ferry	3	For UK/NL ATG
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RoRo Ferries Pax and Freight

	Support of JTPs	67	Will support JLPs later
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(Mostly trading shortsea from UK)

	Minelayer	2	
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Heavy Lift Ships (Dock Type)

	Small landing craft transporter	1	For UK/NL ATG
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Tugs

Coastal/ocean/offshore

	Rescue/Salvage	13	
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Annex B

NATO SEALIFT; DRY CARGO VESSELS:

	Apr 82	Apr 83	Apr 84	Sept 85	Sept 86	Sept 87	Change 82-87
Belgium	18	16	15	15	13	13	- 5
Denmark	59	61	56	45	41	51	- 8
Germany	102	103	101	101	98	99	- 3
Greece	85	72	119	106	84	75	- 10
Italy	35	35	33	28	28	28	- 7
Netherlands	85	84	80	76	73	62	- 23
Norway	69	53	57	50	39	9	- 60
Portugal	14	14	14	14	7	3	- 11
Turkey	15	15	15	15	15	14	- 1
United Kingdom	138	115	117	124	100	94	- 44
<b>Total</b>	<b>620</b>	<b>568</b>	<b>607</b>	<b>574</b>	<b>498</b>	<b>448</b>	<b>- 172</b>

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## UK CONTRIBUTION TO NATO SEA LIFT SHIP LIST

TYPE	Apr '82	Apr '83	Apr '84	Sept '85	Sept '86	Sept '87
Break Bulk	68	49	49	51	43	40
Container	54	51	52	51	43	41
Ro/Ro	16	15	16	22	14	13
<b>Total</b>	<b>138</b>	<b>115</b>	<b>117</b>	<b>124</b>	<b>100</b>	<b>94</b>

## NATO SEA LIFT SHIP LIST

TYPE	Apr '82	Apr '83	Apr '84	Sept '85	Sept '86	Sept '87
Break Bulk	361	301	325	297	229	183
Container	175	181	195	194	191	192
RoRo	84	86	87	83	78	73
<b>Total</b>	<b>620</b>	<b>568</b>	<b>607</b>	<b>574</b>	<b>498</b>	<b>448</b>

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Annex D

UK WARTIME SHIPPING SUPPLY DEMAND

SHIP TYPE	*D E M A N D	E X C E S S / D E F I C I T		
		Using British Flag Exc' Hong Kong	Using British Flag inc' Hong Kong	Using British Flag inc' Hong Kong and Flagged Out
<u>Tankers</u>				
1,000-10,000 dwt	26	67	78	92
10,000-40,000 dwt	197	- 81	- 59	- 39
40,000-80,000 dwt	18	6	8	9
80,000-150,000 dwt	11	- 1	4	18
Over - 150,000 dwt	29	- 4	0	2
<u>Dry Bulk Carriers</u>				
5,000-40,000 dwt	67	- 7	46	54
40,000-80,000 dwt	11	1	54	66
80,000-150,000 dwt	28	- 19	0	13
Over 150,000 dwt	4	2	14	16
<u>General Cargo</u>				
Below 5,000 dwt	449	- 252	- 230	- 162
5,000 dwt and over	588	- 534	- 507	- 478
<u>Containerships</u>				
5,000 dwt and over	120	- 63	- 40	- 34
<u>Ro/Ro</u>	129	18	20	29
<u>Tugs</u>	56	208	230	262
<u>Large Passenger Ships</u>				
	3	5	6	9
<u>Heavy Lift Vessels</u>	1	- 1	- 1	- 1
<u>Others</u>	192	384	394	456

\* Demand = Total of military reinforcement, naval support, US military Sealift and identified civil requirements.

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Annex E

VESSELS IN NATO POOL: 1983-1987

The main figures in the table below show the total numbers in the NATO pool; the bracketed figures show the UK contribution.

VESSEL TYPE	1983	1984	1986	1986	1987
Tankers (all types)	1486	1402 (290)	1285 (232)	1246 (227)	1106 (186)
Dry Bulk Carriers	1490	1501 (249)	1398 (243)	1306 (243)	1188 (227)
General Cargo	1697	1597 (176)	1451 (132)	1324 (146)	1082 (115)
Containership	330	415 (77)	438 (73)	432 (74)	420 (62)
Ro/Ro	262	239 (40)	283 (38)	297 (46)	289 (38)
Large Passenger	303	227 (16)	190 (16)	188 (13)	183 (12)
Other (inc helicopter carriers, salvage vessels etc)	-	47 (5)	147 (4)	160 (29)	124 (21)
	5568	5410 (853)	5054 (738)	4953 (778)	4392 (661)

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OFFSHORE MANNING CONTRACTS

Note by the Secretary of State for Transport

PREAMBLE

- 1. The prime concern addressed in this paper is the need to ensure the availability of sufficient merchant ships and seafarers to meet requirements to support the Armed Forces and supply the civil needs of the UK in times of tension and war. The importance of having ships on the Isle of Man and dependent territory registers is that these ships are required to operate with a minimum number of British (or certain Commonwealth) officers, whereas if the ships are transferred to foreign registers, there is no such requirement. The presence of British officers is an important factor governing the availability of these ships
- 2. Decisions on the tax treatment and the associated application of national insurance contributions regulations on seafarers employed under offshore manning contracts could have major implications for this availability.

BACKGROUND

- 3. The recent moves by UK owners to follow the precedent of open registry companies by distancing themselves from involvement in the direct employment of seafarers by the use of foreign and offshore manning contractors has enabled them to reduce operating costs and yet continue to have their vessels manned to a large extent by well qualified British seagoing personnel.
- 4. The facility to develop new offshore remuneration arrangements with gross wage packages has provided the catalyst for a radical change in the conditions of service of seafarers employed on offshore agreements. These involve a significant reduction in fringe benefits, longer voyages and shorter leave periods. Overall savings in wage costs of up to 25% have been quoted by a number of companies as a result of instituting these changed working practices. Within these savings, those directly related to income tax are small. Companies have not encouraged tax evasion; in fact they have often paid for reputable consultants to advise seafarers on their tax affairs. Many of

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the seafarers qualify for 100% foreign earnings deduction. Savings on secondary Class I NI contributions are more significant but the greatest savings arise from the changed conditions of service in the offshore package, for which the gross wage structure was the essential starting point.

5. It is a crucial benefit to owners who use the services of manning contractors that it is possible to control the labour costs which are often the only significant cost variable in this international business. A gross wage structure is controllable simply because there are no unforeseen 'knock on' effects. A remuneration structure which has, as a major element, a range of fringe and social benefits can easily be disturbed by external forces. Recent examples of such changes which have affected companies with direct employment responsibilities have been the decisions to abolish the Upper Earnings Limit on Secondary NI Contributions thus creating a large and unplanned increase in employers' costs and the announcement of the removal of seafarers' EPA rebates.

6. Thus offshore agreements with manning contractors provide a stable environment in which UK shipowners can seek to narrow the gap between gross costs and net wages, and this enables them to compete more effectively with those owners who operate under open registers with seafarers recruited from the international labour market.

7. These developments have allowed UK owners to maintain in employment significant numbers of UK officers and ratings and to continue to register their ships in the Isle of Man and Dependent Territory constituent parts of the British register, where a minimum level of British (or certain Commonwealth) manning is required by statute, rather than to utilise total foreign manning and ship registration.

CURRENT POSITION

8. The Inland Revenue have concluded that there is a general obligation on UK shipping companies to collect PAYE in respect of UK domiciled seafarers employed by offshore manning contractors to crew the companies ships. DHSS may reach a similar conclusion in respect of secondary Class I NI contributions, although the situations are not exactly parallel and some companies' offshore arrangements may well escape this obligation.

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9. The shipping companies think that the responsibility for the control and management of these seafarers rests with the manning contractor who performs the primary employment functions of recruitment, promotion, allocation to ships, imposing discipline and monitoring performance as well as making payment of wages. If, as is the case, the manning contractors are not liable to operate PAYE because they are not based in the UK, the obligations should not fall on the shipping company which only has responsibility for the day-to-day operation and maintenance of the ship and deciding where it will trade. Most of the companies involved have legal advice supporting this contention. Some of them thought they had cleared the position in the soundings they had taken of Inland Revenue before they moved to their offshore arrangements. If the establishment of tax liability becomes a matter between the individual seafarer and the Inland Revenue, those who qualify for 100% foreign earnings deduction will not have their gross wages unnecessarily distorted by PAYE. If it becomes a matter for the shipping company, it means a return to direct involvement in employment.

10. The companies use the same basic argument to contend that in similar circumstances they have no liability to pay secondary Class I NI contributions.

IMPLICATIONS

11. Although the Inland Revenue and DHSS decisions would apply to UK owned vessels flagged anywhere, by far the most immediate and important implication for our strategic planning is the potential effect on the Isle of Man register.

12. Currently there are 104 vessels totalling 4 million deadweight tonnes registered in the Isle of Man (equivalent to two-thirds of the tonnage registered in the United Kingdom). A list of owners and vessels is annexed. These vessels employ some 4,000 seafarers, of which some 2,700 are British residents (UK or Isle of Man). There are very few aliens amongst the remaining 1,300 - a few Phillipinos, but mostly Commonwealth. Around 1,400 British officers are employed, 1,300 British ratings, and 1,300 ratings of other, predominantly Commonwealth, nationality.

13. Unlike at Dependent Territory locations, there are at present no advantages in terms of NIC liability for shipping companies or crews in operating from the Isle of Man. The Manx have their own NI scheme under which the NICs levied are the same as in UK. We know that the Manx authorities have considered but decided against exempting deep sea seafarers

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from this scheme, in order to put them on a par with Dependent Territories. However, the advantages gained by the use of Manx manning contractors employing British crews on offshore terms are still substantial. It has been estimated at a saving of £150k per vessel per year or 20% of total crew costs.

14. If British seafarers working for Manx manning contractors are brought within the PAYE net, there are two courses of action they can take:

- i. The significant number of seafarers who qualify for 100% foreign earnings deduction (FED) may seek employment with foreign owners. To some of these seafarers FED is a relatively new experience brought about by the longer tours of duty involved in offshore employment terms, but many others have previously worked for foreign companies, without any question of PAYE. They have been attracted back to working on British registered vessels by manning contractors providing crews for expanding companies such as Maersk. It is reasonable to suppose that those seafarers will be unwilling to return to, or begin, having PAYE deductions, even if they have the tax paid fully refunded at the end of each tax year.

or

- ii. Those seafarers who are liable to tax may seek a renegotiation of their offshore packages, with the result that shipowners will once again become involved in direct employment. The hard won advantages of recent years, gained at considerable cost, would be lost with the reintroduction of the type of employment packages, including redundancy compensation, which has made UK ships so uncompetitive in the past.

15. If the UK shipping companies involved are not prepared to accept the loss of the British seafarers currently employed by contractors to man their Isle of Man registered vessels, or a return to direct, and costly, involvement in employment, there are three courses of action they can take:

- i. transfer the ownership of the vessels to a foreign subsidiary, removing the registration from the Isle of Man to that country. In this way, British crew could still be employed on the vessels, but no PAYE obligation would fall on the foreign owner. Such

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transfer of ownership would not be difficult in such an international industry, and it should be noted that 90% of the tonnage on the Isle of Man register is ultimately beneficially owned by foreign parents (if Shell is included);

or

- ii. remain on the Isle of Man register, but to a large extent or entirely order the replacement of British crews by other, acceptable, nationalities, eg Irish or certain Commonwealth nationals. PAYE obligations would be reduced because few, if any, British residents would be involved. It should be noted that CP Bulkships have already experimented with an all-Indian crewed vessel on the Isle of Man register. The success of this experiment could persuade others to follow suit;

or

- iii. transfer for registration of the vessel to a foreign flag, ordering the replacement of British crews by foreign nationals, thus avoiding any PAYE obligations. It should be noted that the 3 leading owners on the Isle of Man register already have other vessels; registered under foreign flags.

CONCLUSION

16. The perceived problems arising from the imposition of PAYE and NIC obligations as a result of the Inland Revenue and DHSS investigations are likely to cause companies which have already established new manning practices under offshore agreements to consider other options open to them to retain the benefits of these gross wage agreements.

17. On PAYE the Inland Revenue will have no option but to apply the law according to their interpretation. We believe companies will not involve themselves in the expense of challenging such an interpretation in the Courts. Some will shed their UK nationals, and at least one major operator of Isle of Man registered vessels will transfer the ownership and registration of his vessels to a foreign company. We fear that the Departure of these vessels will encourage others to follow, with, in a very short space of time significant reduction in the tonnage currently registered in the Isle of Man.

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18. Some of this re-registration may be averted if the Inland Revenue would establish a simplified procedure for those seafarers entitled to FED. Instead of those seafarers being made to accept PAYE deductions and then claim a full refund of their payments, Inland Revenue might be able to reach a decision, on sight of the manning contract, to allow the deduction in advance, subject to unforeseen circumstances affecting the contract during the year and producing a subsequent tax liability. It is not possible at this stage to judge whether such an administrative simplification would be sufficient to prevent a flight from the Isle of Man. It would do nothing to save the companies from becoming directly involved again in the employment of those seafarers liable to tax.

19. So far as National Insurance Contributions are concerned, the legal provisions are rather different from PAYE. A mariner's contributions liability depends on a number of factors including where his ship is registered, whether he is normally resident in the UK, where his contract of service was entered into, and whether his employer has a place of business in the UK. With foreign-based manning agencies with no place of business here, a crucial factor governing liability will be the relationship between the agency and the UK-based shipowner. A British shipowner might have no NIC liability for members of the crew on his British registered ship if he used a genuinely independent manning agency, which had no place of business in the UK, to engage and employ them. But much would depend on the contract of employment and the agency's responsibility once the crew was on board ship, and each case would need to be judged on its merits.

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## ISLE OF MAN REGISTER (over 500 grt)

Ann

Total 104 vessels; 4,069,569 deadweight tonnes

Owner	No	(Type) Vessels	dwt
Shell	20	(11 product tankers, 7 tankers, 2 bulk carriers)	2,647,811
Maersk	16	(9 product tankers, 3 gas tankers, 3 OSVs, 1 ro-ro)	570,341
CB Bulkships	12	(12 product tankers)	376,579
Ocean	5	(3 general cargo, 2 ro-ro)	139,665
Rowbotham	17	(17 product tankers)	79,690
John Swire	3	(3 product tankers)	72,663
Ellerman	4	(4 containers)	60,265
Denholm	3	(1 bulk carrier, 1 general cargo, 1 OSV)	36,820
Blue Star	1	(1 container)	27,978
Gibson Tankers	5	(5 gas tankers)	16,713
OIL	4	(4 OSVs)	11,508
Britship	1	(1 product tanker)	8,706
Cenargo	1	( ro-ro)	3,890
Walle	1	(1 product tanker)	3,290
Triport Ferries	1	(1 ro-ro)	2,920
Belfast Car Carriers	1	(1 ro-ro)	2,838
Gotland	1	(1 ro-ro)	1,950
James Fisher	1	(1 ro-ro)	1,658
IOMSP	2	(2 ro-ro)	1,422
Tidewater	1	(1 OSV)	1,200
Sealink	1	(1 ro-ro)	879
Ramsey Steamship	1	(1 coaster)	756

## MERCHANT SHIPPING DECLINE: OTHER COUNTRIES' RESPONSES

## NOTE BY THE SECRETARY OF STATE FOR TRANSPORT

Shipping in NATO Countries: Previous Assistance

Throughout the NATO alliance, experience since about 1975 has been of general contraction in the domestically-registered fleets. In most European countries, the impact of this decline on national war and emergency planning seems not to have been recognised until very recently. The widespread assistance that has been given to merchant shipping owes far more to other factors.

2. In Scandinavia, for instance, the industry's historic role has been as one of the major employers in the economy; it has occupied the kind of position reserved to agriculture further south. In the Mediterranean area too shipping has enjoyed special help, though more perhaps because of the political sensitivity of the maritime communities. In Germany and The Netherlands, assistance has tended to be given as a by-product of aid to ship-building.

3. The North American scene is quite different. In the USA there has been a perception ever since 1938 that a certain minimum fleet under the national flag is needed to support the US Navy. Most US cargo liner companies have as a result received subsidies to offset the extra cost of employing US seamen. The cost of this programme in 1986 was \$288 million, or an average of over \$2.5 million per vessel concerned. Similarly, the US has maintained a Ready Reserve Fleet, partly laid up, to supplement the merchant marine. Canada meanwhile has until recently pursued a policy of allowing market forces to determine the size of its fleet (except for its coastal and offshore vessels). There are now however governmental proposals for a second ship register, mirroring developments in Europe, which would exempt Canadian shipping companies from domestic tax liabilities as a means of improving the competitiveness of the Canadian fleet.

New Trends

4. Certain new trends are now beginning to emerge in the policies of Alliance members in response to the challenge posed by Third World fleets and the depression in the industry that has compelled so many owners to retreat to flags of convenience. Although investment grants and special de-preciation allowances are still prevalent (notably in France, Italy and Germany) there is a growing awareness that aids for new investment have aggravated the over-tonnaging that was largely provoked by Japan and Korea. Denmark and The Netherlands have recently withdrawn part of their schemes. Attention instead has focussed on the problem of the high cost of employing European crews. A variety of measures have been taken as a result:-

- France is implementing a 23-point plan, costing about £140m over two years for a fleet significantly smaller than the UK's. Measures include re structuring grants to companies who are prepared to reduce manning levels and special adjustments to the arrangements for social security payments.
- In 1987, Norway set up a parallel register on which owners could use crews of any nationality with minimal Norwegian tax liabilities.
- Denmark is expected to announce any day now the creation of a similar special register with wide exemptions from personal tax and social security obligations for Danish seafarers employed on its vessels. (Sweden is also on the point of adopting a scheme of assistance which is widely reported to lay the emphasis on personal tax relief).
- In The Netherlands, it has been announced that tax and social security concessions will be granted to shipowners and seafarers; details are being worked out by the Ministries concerned.
- Belgian owners have been in negotiation with the Luxembourg government over the establishment of a new register there which would probably entail low corporation tax as well as the freedom to employ foreign crews.
- In Greece, where seafarers have long enjoyed a 5% rate of personal tax against the national average of 40%, steps have been taken to reduce crew costs by allowing the use of a certain percentage of foreign nationals.
- Germany, apparently, have earmarked a sum of some £250m by way of assistance to German flag vessels for allocation between now and end 1991. Details of the scheme have not been made public but it is believed to be planned to supplement the present shipbuilding assistance arrangement.

5. Within the EEC, the Council of (Transport) Ministers has called on the Commission to make proposals for arresting the decline of the Community fleet. In discussion of the options, the majority of Member States have suggested that the cost of employing EEC seafarers would most appropriately be reduced by fiscal action.

6. It is notable that the US programme of regular direct operating subsidies has not been imitated in any other NATO country; nor has any interest been shown in buying up old vessels for moth-balling.

## Conclusions

7. Within Europe, support for merchant fleets has in the past been provided mainly through schemes to assist capital investment. There is now a strong tide flowing in the direction of helping owners to reduce their crew costs, so as to encourage them to stay on national registers. Partial relaxation of nationality requirements, which has enabled foreign ratings to be employed, generally while national officers are retained, is one method. But increasingly attention is focussing on the creation of special personal tax and social security regimes for seafarers. There is little evidence of these arrangements being limited to seafarers who do not maintain a residence in the country concerned, though in Norway (and probably under the new Danish scheme) concessions are not available to those employed in coastal shipping or off-shore trades.

## ACCESS TO MERCHANT SHIPS IN CRISIS AND WAR

Note by the Secretary of State for Transport

Introduction

1. In crisis and war we would obtain access to merchant ships through requisitioning or chartering (on the market or through multilateral and bilateral arrangements with other governments). Provision of war risks reinsurance by HMG provides a valuable incentive to ensure the availability of ships at such as time.

Requisitioning

2. In a period of tension, before the assumption of emergency powers need to be taken, ships would be requisitioned by use of the prerogative power when there is an imminent threat to the United Kingdom or its dependencies. The prerogative was last used to requisition ships for the Falklands Task Force. The power extends to British ships on the United Kingdom register and the registers of dependent territories; but it has not been tested whether this power extends to any ship beneficially owned by an individual or company entitled to register a vessel in the United Kingdom or its dependent territories.

3. During a developing crisis, the Government of the day would need to consider the implementation of emergency powers. Draft legislation has recently been comprehensively reviewed by officials. These would enable HMG to requisition any ship in which a British company or national has a majority controlling interest, either direct or indirect, regardless of its current registration.



4. Despite the potential availability of such wide powers we have considered it prudent to reach agreements with major Flag of Convenience countries to ensure that they would not seek to impede the requisitioning of any British controlled ships on their registers during an emergency. Negotiations through the FCO with Bahamas, Liberia, Panama and Vanuatu are progressing well. A Memorandum of Understanding with Bahamas should be signed shortly, and it is our intention to complete the remaining agreements by the end of this year. There are currently on these four registers about 150 ships owned in the UK and a further 540 ships owned in dependent territories (mainly Hong Kong). The former have already been included in our tables of available ships.

#### Chartering

5. Apart from requisitioning, we could obtain access to ships through chartering either from shipowners on the market or from other governments through multilateral arrangements in NATO or through separate bilateral agreements.

6. We have developed plans for and exercised our shadow organisation (National Shipping Authority) which would, amongst other things, be responsible for obtaining ships on the market. It is not possible to determine how many ships could be obtained by this means, although the number could be significant.

7. Through our membership of NATO we have developed pooling arrangements for ocean-going ships of 1600 GRT and over. These ships would be allocated to members in the overall interests of the Alliance. The NATO pool should provide some mitigation of the more acute supply problems although we cannot be sure that the UK would be a net beneficiary from the arrangement. Unfortunately the figures indicate that the pool will be short of ships that are in currently short supply in the UK, and so it is doubtful whether the pool would compensate significantly for our deficiencies of deep sea ships.

We have long standing bilateral agreements with Denmark and Norway under which we agree to reinsure their merchant fleets in war against a common enemy in return for a first refusal on any ships not required by them. With the subsequent development of NATO plans for ocean-going ships, the agreements with Denmark and Norway effectively cover only smaller ships such as coasters. We intend shortly to open discussions with the Scandinavians to bring these agreements up to date. We have also begun discussions with the Netherlands Government about a similar arrangement covering their smaller ships.

9. Bilateral agreements with Denmark, Norway and the Netherlands would make available up to 1500 coasters for our use. They have not been included in the supply figures since the numbers are not certain; although this substantial additional supply should easily compensate for our deficiencies of coasters and go some way towards meeting our shortage of general cargo ships.

#### War Risks Reinsurance Agreements

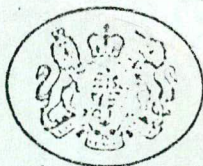
10. Agreements between HMG and UK Mutual War Risks Associations have existed since the Second World War. We have recently completed a comprehensive overhaul of the agreements to take account of changes in insurance practices in the market and the lessons we learned during the Falklands hostilities. The agreements have been extended to enable HMG to provide reinsurance cover for ships that are not on British registers. To qualify for reinsurance such ships will have to be on one of the registers with which we have negotiated agreements on availability; and the owners will have to have signed a Contract of Commitment (Annex I). This contract will guarantee that ships covered will be made available to HMG in crisis and war. Our arrangement for war risks insurance are more comprehensive than those developed by any other NATO country including the United States and provides us with a major incentive by which access to ships can be obtained in war.

Summary

11. The prerogative power was used effectively to requisition United Kingdom ships during the Falklands hostilities; and could be used rapidly in a future emergency. Comprehensive draft emergency legislation has been prepared, and could also be introduced quickly. It includes provisions for requisitioning all British controlled ships. We are negotiating agreements with the major Flag of Convenience States to minimise any legal difficulties that might be experienced if we requisition ships on their registers (which will help to ensure the availability of up to 150 ships subject to their owners signing contracts of commitment). We have developed machinery, that can be activated at short notice, to charter ships on the market. We have negotiated comprehensive multilateral arrangements for access to ships owned by our NATO Allies; we have bilateral agreements (which are being reviewed and extended) which will make available up to 1500 coasters. To underpin these arrangements we have extended our war risks reinsurance arrangements to cover both British and foreign registry ships. Reinsurance of Flag of Convenience ships will only be provided for ships that will be made available to HMG in crisis and war. A draft Contract of Commitment for this purpose has been prepared.

12. The UK has been to the fore in planning in this area and there is no other country in the Alliance that has developed such comprehensive and up to date powers, agreements, and machinery that can be activated at short notice to obtain access to merchant shipping in crisis and war.

23 March 1988

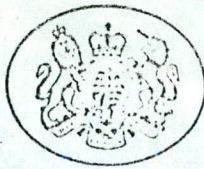


CONTRACT OF COMMITMENT OF SHIPS

An Agreement made this \_\_\_\_\_ day of \_\_\_\_\_ 198 between the Secretary of State for Transport (hereinafter referred to as "the Secretary of State") of the one part and \_\_\_\_\_ (hereinafter referred to as "the owner") of the other part

Whereas

1. The owner is the owner of, or has authority to commit, the vessels named in the list annexed hereto (hereinafter referred to as "the committed vessels") which are registered in \_\_\_\_\_
2. The Secretary of State under section 1(1) of the Marine and Aviation Insurance (War Risks) Act 1952 (hereinafter referred to as "the Act of 1952") is empowered to enter into agreements with any authorities or persons for the reinsurance by him of any war risks against which any ship is for the time being insured in so far as such risks arise during the continuance of any war or other hostilities in which Her Majesty is engaged (hereinafter referred to as "Queen's enemy risks"), and has entered in to such agreements with certain War Risks Associations.
3. British War Risk Associations are reinsured under the Act of 1952 against Queen's enemy risks and are prepared to admit vessels registered outside British territory for cover against War Risks including Queen's enemy risks if those vessels are covered by that reinsurance.
4. The Secretary of State is prepared to give such war risks reinsurance for such vessels as will be available to Her Majesty's Government during war or other hostilities in which Her Majesty is engaged.
5. The owner is desirous of entering a War Risks Association reinsured pursuant to the Act of 1952 for the purpose of insuring the committed vessels against Queen's enemy risks.



Now therefore it is hereby agreed by the parties as follows:

1. The owner commits himself to make available to Her Majesty's Government the committed vessels, during any period following an Order in Council made under prerogative powers empowering the requisitioning of ships, or on the passing of emergency legislation in defence of the Realm empowering the requisitioning of ships.
2. During a period referred to in clause 1, the owner shall make available any committed vessel identified in the request for use by or at the direction of Her Majesty's Government, wherever such vessel may be, for such period or periods of time as required by Her Majesty's Government.
3. Any committed vessel which is taken up pursuant to this Agreement will be taken up on the comparable terms and conditions as any British vessel requisitioned under the same powers.
4. The Secretary of State undertakes to provide the owner with a certificate to enable the owner to obtain Queen's enemy risk cover during the period referred to in clause 1 for the committed vessels with a War Risks Association reinsured by Her Majesty's Government pursuant to an agreement under the Act of 1952 (and that the committed vessels will accordingly be reinsured by the Secretary of State).
5. This voluntary contract of commitment shall not affect any other rights of Her Majesty's Government to requisition any committed vessel.
6. The owner undertakes to advise the Secretary of State immediately that he ceases to be the owner of, or to have authority to commit, any of the committed vessels.
7. This contract may be terminated on 6 months notice by either party.