

PO-CH/NL/0187

PART D



PART D

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**SECRET**

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PO -CH /NL/0187



PART D

CHANCELLOR'S 1988 PAPERS  
ON THE SHIPBUILDING  
INDUSTRY

7810/NL/0187

PO -CH

PART D

Begin: 18/5/88

Ends: 11/7/88 (CONTINUED)

DD: 25 years

6/9/95





## Inland Revenue

Policy Division  
Somerset House

FROM: I FRASER

18 MAY 1988

1. MR LEWIS
2. FINANCIAL SECRETARY

## TAXATION OF SEAFARERS

1. At your meeting on 10 May you asked us to consult the Department of Transport to see if we could form any clearer picture of what would be the effect and the cost of the change set out as option (b) in Mr Lewis' minute of 6 May (relaxing the conditions for the 100 per cent foreign earnings deduction by increasing the number of days which can be spent in the UK from 62 to 90, and the corresponding fraction from 1/6 to 1/4).

2. DTp officials were pessimistic about getting figures which would be anything more than an informed guess. In particular, they have no firm figures on how many seamen are employed by foreign crewing agencies or on the pattern

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cc	Chancellor	Chairman
	Chief Secretary	Mr Isaac
	Paymaster General	Mr Painter
	Economic Secretary	Mr Beighton
	Sir P Middleton	Mr Lewis
	Mr Scholar	Mr McGivern
	Mrs Case	Mr Cleave
	Mr Revolta	Miss Rhodes
	Ms Sinclair	Mr Keith
	Mr A R Williams	Mr R H Allen
	Mr Cropper	Mr O'Brien
	Mr Tyrie	Mr Fraser
	Mr Call	Mr Alpe
	Mr C Jenkins (OPC)	Mr I Stewart
		Mr K Allen
		Mrs C Williams
		PS/IR



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of their visits to the UK. However, the New Clause to the Finance Bill tabled by Sir William Clark on similar lines to option (b) enabled them to sound out GCBS contacts to obtain their broad impressions on the likely effect of such a relaxation (which GCBS themselves suggested in a memorandum to the Transport Select Committee dated November 1986). The information we have obtained reflects mainly those UK seafarers who are on British ships (the New Clause is drafted in those terms) and not those on foreign owned ships. However it is likely that many of the latter either already qualify for 100 per cent relief or enjoy a de facto exemption because they have slipped out of our net.

**NUMBERS AFFECTED**

3. The information received suggests that about 25 per cent of the 14700 UK seafarers working on deep sea ships currently qualify for 100 per cent relief and that a further 50 per cent might qualify under the relaxed conditions suggested under option (b). The relaxed conditions might also enable 2-300 seamen operating on short sea bulk ships to qualify. Table A attached illustrates the impact of the relaxation of the rules and Table B shows the numbers of new beneficiaries broken down into type of ship. (The assumption that the same percentage of seafarers on each category of ship would qualify for the relief is made in the absence of any other information to the contrary).

4. To assess the real, rather than theoretical, impact on seafarers of the relaxation, it is necessary to attempt to establish how many UK seafarers are now enjoying de facto exemption because of non operation of PAYE. DTp have made the broad assumption that seafarers on UK mainland registered ships are likely still to be directly employed by shipping companies and we have then made some adjustments, based on our own limited information, for significant areas where we know this assumption to be mistaken. Table A shows that the relaxation would leave



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about 8500 seafarers on deep sea ships unaffected (either because they do not pay tax now and would not under the revised conditions or because they pay tax and would still do so). There would on these figures be about 5500 gainers and over 1000 who would lose the de facto PAYE exemption they now enjoy once we require PAYE to be operated.

COST

5. On the assumption that all those presently liable paid their liability, our best estimate, in the light of this new information, of the cost of relaxing the conditions (but limiting the relief to British ships) is just over £20 million. If we take into account only those currently paying tax, this cost would drop to £15 million (but we would also gain £5 million from enforcing PAYE: the net cost would therefore be £10 million). If the relaxation is not limited to British ships the cost, would be higher, but - in practice - not much higher.

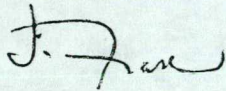
NEW CLAUSE 18

6. If the relaxation proposed under option (b) is limited, as Sir William Clark's New Clause is, to crew on British ships (ie ships registered in the UK, IOM, Channel Islands, Bermuda, Gibraltar and HongKong), this would appear to target the relief more effectively. But it would mean that seafarers could qualify for relief under two different rules depending on the ship on which they worked. Since most seafarers who qualify for the relief do so because their visits between voyages are less than the permitted fraction of the total period under review, further consideration would have to be given as to how entitlement to the relief could be achieved by seafarers whose crewing agencies may direct them alternately to British and non-British ships or whose ships were reflagged whilst they were serving on them. Special rules to deal with this situation are likely to be complex. Moreover, if this relaxation significantly advantaged seamen on British ships, there may be EC objections.



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7. On the basis of the information now received the benefit of option (b) to seafarers may be greater than we previously thought. To the extent that the value of the relief accrues to the shipping companies, the value of the relief per ship will benefit those operating cruise ships and liners more than those operating tankers and bulk ships because crew numbers are so much higher per ship. Although its similarity to the GCBS proposal reflected in the New Clause suggests it would be warmly accepted by that body, it does not overcome the lack of a mechanism to ensure this further money finds its way into the accounts of the shipping companies about which GCBS more recently expressed concern.



I FRASER



TABLE A

UK DEEP SEA SEAFARERS

ESTIMATED IMPACT OF RELAXATION OF RULES FOR 100 PER CENT RELIEF

	TOTAL	PAYE operates	PAYE does not operate
a. Already benefit from 100% relief	3670	2660	1010
b. New Beneficiaries if rules change*	7340	5330	2010
c. Not affected by rule change	3670	2660	1010
TOTAL	<u>14680</u>	<u>10650</u>	<u>4030</u>

TABLE B

Breakdown of new beneficiaries\* (b. above) into types of ships.

TYPE OF SHIP	Total	PAYE operates	PAYE does not operate
Liners	1030	770	260
Cruise	1700	1050	650
Tankers	3070	2330	740
Other bulk	1540	1180	360
TOTAL	<u>7340</u>	<u>5330</u>	<u>2010</u>

\* In addition, it is thought that about 250 seafarers on short sea bulk ships will qualify as new beneficiaries (of whom about 200 are currently subject to PAYE).





Mackie's

Ch.

Mr King's office telephoned. They thought he might want a word on the telephone about this (or perhaps a word in the margins of Prime Minister's questions). You may like to have the pps. in case he follows this up.

2. I got the impression that Mr King thinks the FSI undertakes to seek to persuade you to come round to his point of view. I don't think the FSI did, but you will want to be insistent.

pmf

FROM: M SHARRATT  
DATE: 18 MAY 1988

MR TAYLOR

Ch / NB 'X'  
25 18/5cc PS/Chief Secretary  
PS/Financial Secretary  
PS/PMG  
PS/EST  
Sir Peter Middleton  
Mr Anson  
Mr Philips  
Mr Monk  
Miss Peirson  
Mr Burgner  
Mr Waller  
Mr White  
Mr Call

## JAMES MACKIE &amp; SONS

X || Mr King, at this afternoon's meeting with the Financial Secretary on his proposed rescue of James Mackie, announced his intention of seeking an early meeting with the Chancellor to resolve what he sees as a difference in interpretation of the outcome of the E(A) meeting on 25 April. He may seek to do this in the margins of Cabinet tomorrow.

2. Mr King believes that he has E(A) approval to rescue the company and that what has now to be resolved was how this should be done. But the minutes of the meetings on 29 March and 25 April do not support that view. Our reading of the minutes of that meeting is that E(A) would agree to support for Mackie providing:

- a. it did not involve the Government taking an equity stake;
- b. support could be in the form of a secured loan; and
- c. it did not involve the Government assuming responsibility for Mackie's past liabilities.

I understand that this accords with the Chancellor's view of the outcome.

3. At today's meeting, on the premise that he had agreement to support Mackie, Mr King sought Treasury technical agreement that



his latest proposals, involving a mixture of convertible loan stock and grant, presented the least unsatisfactory way forward given the conditions imposed.

4. The Financial Secretary argued that the conditions imposed by E(A) could not be met and that the economic arguments should therefore prevail and the company be allowed to close. He accepted that if the company must be supported for political and social reasons, then the package Mr King was now putting forward was probably the least worst approach that could be devised.

5. Contrary to the impression conveyed by Mr King, there is also another important unresolved point. Namely, his officials have yet to convince DTI and ourselves that the present proposals do not exceed EC limits. If they do breach the limits, either they would need to be reshaped to bring them inside or alternatively the Commission would have to be notified. This is being pursued urgently with DTI officials.

6. I attach the latest draft letter which incorporates most of our comments on the previous version. We will be discussing this with NI officials tomorrow.



M SHARRATT



C O N F I D E N T I A L

[REVISED TO TAKE AC OF ALAN WHITE'S BIRTH]

THIRD DRAFT OF LETTER FROM SECRETARY OF STATE TO PRIME MINISTER

JAMES MACKIE & SONS LIMITED

1. During the discussion at the E(EA) meeting of 25 April about the problems of this company in West Belfast, colleagues recognised the case for preventing closure of the company and indicated a wish to see Government assistance made available in the form of grant and loan and were strongly opposed to any equity investment.

2. The point was however made that avoiding an equity involvement could create difficulties over assurances previously given to PAC and that a sufficient degree of influence would be necessary to ensure that much needed management changes were put in place. Colleagues also suggested that we should not allow the existing owners to reap the potential rewards of a rescue made possible wholly by Government support. I was asked to consider the prospect of a £20m secured loan for the company and to consult with the Chancellor on this possibility.

3. Firstly I have considered fully the preferred option of putting in a £20m secured loan. I have sought advice on this point from Lazards who have been advising IDB. I have reluctantly concluded that this proposal will not work in the particular circumstances of the Mackie case which has been considered on social and political grounds and not as a normal commercial case. The Lazard view, which I share, is that there will be inadequate security within the company to support such a loan. In response to a specific request by IDB the company's bankers have refused to release any part of their security on the existing overdraft; the new assets to be brought into the company will not provide sufficient collateral to secure adequately the Government investment [and we are advised that we could risk an action for fraudulent preference by unsecured creditors if they were to lose money on a possible failure of the company].

C O N F I D E N T I A L



C O N F I D E N T I A L

4. Within the constraints outlined in E(EA) we have been looking for a solution which might offer a practical way forward. I have to say that it has been difficult to come up with a solution which meets the clearly expressed wishes of colleagues without at the same time proposing an investment of public funds in a manner which could be difficult to defend as a proper and sensible use of public money. We have, however, produced an outline proposal which I am willing to support. Much work of a detailed nature would remain to be done but I am anxious to move forward as quickly as possible since the company's situation continues to be precarious. I have taken steps in the short term to extend the full £2m guarantee to ensure that the company does not collapse whilst we are resolving the matter.

5. The proposal is that I would authorise IDB to make available to the company assistance in the form of grant and loan. The grant would amount to £7.5m and the balance of £12.5m would be made available in convertible loan stock. Our original intention to phase the assistance in tranches of £6m, £8m and £6m with stringent performance targets set at each stage would stand. The planned application of the funds on a financial year basis would be as follows:

		£'000						
		Phase 1		Phase 2		Phase 3		Total
		1988	1989	1990	1991	1992	1993	
Capital grants	-	2,554	1,175	1,471	1,532	725	7,457	
Convertible loan	-	3,500	2,000	3,500	3,500	40	12,540	
		6,054	3,175	4,971	5,032	765	19,997	

6. Government would not take any direct shareholding in the company. The convertible loan stock would, however, carry rights to convert into shares in order to ensure that any potential capital gain which accrued on a future sale of the company would accrue largely to Government rather than merely to the existing owners. In 1992/93



C O N F I D E N T I A L

when our professional advice is that a sale is most likely to be feasible, conversion of the loan would result in Government acquiring a holding of 86% of the ordinary share capital of the company, hence placing it in the position of being able to strongly influence the future ownership of the company. We would impose conditions on the package which would enable us to ensure that the necessary and quite essential changes to strengthen top management were made and other appropriate conditions would also be imposed on the basis of detailed professional advice.

7. This proposal is in line with the view of colleagues in that it avoids any Government shareholding in the company. However, the company's ability to continue to trade and hopefully to return to profit and re-equipping is wholly dependent on the injection of public money. In these circumstances I am advised that it is not possible for Government to avoid responsibility for those liabilities of the company which will be incurred in the normal course of trade with unsecured creditors (including redundancy payments), if the company should fail during the period of the rescue attempt. Although this responsibility must be assumed there are three important mitigating factors. First, Government has an existing guarantee commitment to the company's bankers of £2m whose release will be negotiated as a condition of the proposed injection of £20m by IDB and our firm expectation is that any possible obligation to creditors in the rescue period other than redundancy payments would be less than that existing guarantee commitment. As a result IDB would not have any future commitment to the Bank which would thus be in the position of dealing with the company on a normal security risk basis. Secondly, steps will be taken to ensure that no historic undisclosed liabilities are inadvertently inherited by Government. IDB has not come across any such 'skeletons in the cupboard' but would employ professional accountancy and legal advice to subject the company to a rigorous investigation. In the unlikely event that any major difficulty arises I would return to colleagues, before any commitment was entered into by IDB. Thirdly, it will be made clear to the bank that any possible future

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acceptance of liabilities by Government to unsecured creditors will not extend to any of the bank's lending to the company.

8. This solution leaves the present ownership of the company with the Trust since Northern bank has now made it clear that it will not take an equity investment in the company unless it has a matching investment from Government in like form. This was the proposition considered but rejected by E(A) on 25 April. I would propose however to explore ways of strengthening the Trust, with a view to the appointment of a new Trustee or Trustees with relevant business experience.

9. Whilst the proposal outlined meets the wishes of E(A) it presents certain difficulties. PAC was assured after the De Lorean case that in future industrial support would only be given to projects in which a substantial part of the financial resources is provided by the private sector. Despite vigorous efforts to find fresh private sector funding for Mackies, it has been clear for some time that its rescue depends almost wholly on Government support. Whilst this runs counter to the assurance to PAC, the fact is that the decision to support Mackies has been made by Ministers on social and political grounds in the context of the particular difficulties of West Belfast. It is a unique set of circumstances and not a straightforward case of industrial development assistance to a normal commercial project. I would propose to arrange to make clear to the House the exceptional nature of this support by way of a Written Answer.

10. In recognition of Government's dominant position in the arrangements for financing the company, I originally put to E(A) proposals involving a significant degree of Government shareholding and control. The changes which have been made in these aspects of the proposal meet the wishes of colleagues but have inevitably brought with them a dilution in the degree of accountability; it also does not accord with the clear recommendation of our professional advisers, Lazards, who recommended a significant ownership and

C O N F I D E N T I A L



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control position to facilitate the rescue of the company and its successful return to the private sector. The proposed arrangements are weaker in this regard but I fully understand and appreciate the concerns which colleagues expressed at E(A).

X | 11. I am satisfied that the package falls within the established EC guidelines for the provision of financial assistance to projects within Northern Ireland. [Recent discussions with officials in DTI have confirmed this.] The Foreign Secretary had suggested that it might be worthwhile sounding out the EC Commission about whether the proposals would be notifiable under Articles 92 and 93 of the Treaty since early warning and the political background might minimise any difficulties. The EC ceilings were set for all Member States in a 1979 Communication of the Commission on Regional Aid Systems; as the proposed funding for Mackies is not within an industry with special EC restrictions and as it falls within the EC limits for Northern Ireland there is no requirement to seek approval from Brussels. Indeed, I believe any informal consultation with Brussels would be wholly undesirable, introducing further delay and frustration in circumstances where we are acting within well established delegated limits. It would also risk French intervention given that Mackies' main competitor is French.

12. When I first submitted proposals to colleagues I emphasised the very compelling reasons for supporting the company on social and political grounds. I still take the view that these are strong reasons for supporting Mackie. The company employs 1,000 people in an area of acute social deprivation and its continued survival will be a vital base for the economic regeneration of West Belfast. Support for the company would demonstrate in the best way possible Government's long-term commitment to the economic future of Northern Ireland and to West Belfast in particular. It would as I have said before provide the opportunity of employment for Catholics in West Belfast and illustrate Government's real determination to prevent West Belfast degenerating into a complete economic and political wilderness.

C O N F I D E N T I A L



C O N F I D E N T I A L

13. I believe, that this proposal does offer a workable way forward and I believe it fits well with the very clearly expressed views of colleagues at two recent Committee meetings. I would be grateful for the endorsement of colleagues to this outline proposal following which I will set in train the necessary detailed consultations and negotiations to implement the proposals.

TOM KING

C O N F I D E N T I A L








About 1,000 are already exempt; about another 2,000 would become exempt with the relaxation, leaving another 1,000 who might pay tax on the reintroduction of PAYE. (But the relaxation would be likely to induce some behavioural change. Some of those who on present information would not qualify could change their working patterns to qualify).

5. In addition, about 5,000 seafarers would benefit for whom PAYE is now operating (out of a total of about 11,000, of whom 3,000 already qualify). That could be regarded as a "wasted" cost in the sense that these seafarers are not enjoying a de facto tax exemption and there is, therefore, no reason to compensate them for the reintroduction of PAYE. But they are all people who might in future move away from UK/IOM ships, and to the extent that the change might prevent or delay that, this element of the cost could also be regarded as "effective".

6. So the result, overall, would be that of the approximately 15,000 UK seafarers in the deepsea trades, the proportion qualifying for 100% foreign earnings deduction would increase from about 25% to 75%. (But this conclusion is based solely on informal  department of Transport soundings of GCBS on the broad effect of their previous similar proposals.)

7. The information we have is not good enough to evaluate other options eg to answer the question "What would the rules need to be so that virtually all deepsea seafarers qualified?" In practice - allowing for some behavioural change - this proposal is probably well on the way to that. And Ministers could, of course, rest on the proposition that they would be giving all that the GCBS had asked for.

#### Cost

8. In theory about £20m. In practice, about £15m.

9. There remains the major open question - how much of the benefit of this (or any other) tax reduction for seafarers would in practice accrue to the shipping companies to reduce their



operating costs? I am afraid we cannot begin to provide an answer. We can only note that the benefit to the shipping companies could be less, perhaps much less, than the cost to the Exchequer.

Should a new relief be limited to "British" ships?

10. New Clause 18 is limited to "British" ships. As Mr Fraser explains, that includes ships on the registers of the Crown Dependencies and the Dependent Territories.

11. If a new relief is to be introduced primarily for defence reasons, it may seem self-evident that it should be restricted to "British" ships. In practice the advantage would be largely presentational, and there are strong arguments for letting the relief run more widely. A "British ships" limitation

- would make the relief considerably more complex - and, important in this context, less certain for the seafarer
- might raise problems with Brussels
- would in practice save little revenue since we get little tax from UK seafarers working overseas on ships on foreign registers.

Starting date

12. If Ministers wish to introduce a relief of this kind it would be convenient to have it backdated to 6 April 1988 to minimise the number of people paying tax when PAYE is reintroduced, part way through 1988-89. (We would need to give further thought to the precise form of the starting provisions since many "qualifying periods" would span 6 April 1988).

Drafting

13. If Ministers are minded to add a clause on seafarers to the present Bill, we ought to start work on it shortly, at least on a contingency basis.



Prime Minister's Group

14. The next step will be the preparation of a further note for the Prime Minister's Group. We shall need some guidance on the ground Ministers would like it to cover and the line it should take.

15. In the Prime Minister's Group, the Chancellor will want to avoid having "given away" a new tax relief, for the sake of getting it in this year's Finance Bill, before the whole shipping package is settled. If there is any danger of that happening, and you wish to leave open for the time being the question of whether a new relief should be introduced, we see no particular difficulty in an announcement, after the Finance Bill, of backdated legislation to be included in the 1989 Finance Bill. To reassure the shipping industry, it would probably be helpful if any announcement could be accompanied by the publication of a draft Clause (at the time or as soon as possible afterwards) and an indication that Ministers had authorised us to operate the new provision forthwith (as a temporary ESC).

Evaluation

16. But Ministers will in any case, we assume, want to see the outcome of Department of Transport's work on subsidies before taking a final view on whether to argue for tax reliefs or subsidies (Mr Taylor's minute of 6 May; a separate minute of the same date records the Chancellor's decision to offer the BES relaxation in this context in any event). Department of Transport are working on a first draft paper to explore in more detail their subsidy proposals, but Treasury do not expect to be consulted on it before next week.

17. We take the objectives of the Prime Minister's group to be

- a. to mitigate the adverse reaction to the reintroduction of PAYE



- b. to provide assistance with crew costs generally
- c. to retain on the UK/IOM registers sufficient ships of the types required to meet defence needs.

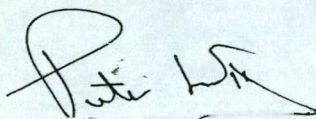
18. If Treasury Ministers' objective with this proposal is limited to (a.) - and that was our understanding at your last meeting - then the very by-and-large figures Department of Transport have given us suggest it would be a reasonably complete offset to the reintroduction of PAYE.

19. Insofar as the relief would apply to a large proportion of all UK seafarers in the deep-sea trades, including many for whom PAYE is still being operated, it might be regarded as helpful with reducing crew costs generally (objective (b.)). But the impact on crew costs is very uncertain and likely to be limited. The Department of Transport paper on offshore manning accepts that the element in wage cost savings achieved by shipping companies in going offshore which can be directly related to tax is small; and GCBS have made the point recently that there is no mechanism for translating seafarers' tax savings into reduced running costs for the shipping companies.

20. Such limited effect as there might be on crew costs would not be directed towards specific categories of ships. This proposal could therefore not be seriously regarded - except in a very limited and indirect way - as encouraging the retention of the types of vessel required for defence on the UK/IOM registers.

21. A very specific tax relief of this kind would be an obvious candidate for policy evaluation. At the moment we have no very clear or precise, quantified, objectives - particularly in relation to (b.) and (c.) - against which we could, if asked, structure any future policy evaluation.

22. We would, of course, be happy to discuss this further with you.

  
P LEWIS



SECRET


 CC-CST, FST, AMG  
 EST, Sir P. M. ...

 Mr. Anson, Mr. Phillips  
 Mr. Mason, Miss Pearson  
 Mr. Buegner, Mr. Waller  
 Mr. Atkinson, Mr. Sturges  
 Mr. ...

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

 Martin Donnelly Esq  
 Private Secretary  
 Secretary of State for Northern Ireland  
 Whitehall  
 LONDON SW1A 2AZ

A handwritten signature in dark ink, appearing to be 'M.P.' or similar initials.

19 May 1988

Dear Martin,

JAMES MACKIE

Your Secretary of State and the Chancellor this afternoon discussed the next steps on James Mackie.

Your Secretary of State said that negotiations now seemed to have reached an impasse, as it was clear to all concerned that a rescue on the terms preferred by E(A) - a secured loan with a floating charge on the company's assets - was not feasible. There seemed to be agreement that your Secretary of State's revised proposal represented the least unsatisfactory way forward of the remaining alternatives, but the Treasury did not accept that a rescue on these terms was consistent with the E(A) remit.

Your Secretary of State set out his reasons for believing that we had to proceed on the revised proposal. Finding the money was not a problem: he would accommodate it within his block, and was not registering a bid. He likened Mackie's position to that faced by Rolls Royce in 1971 - short-term difficulties so severe that no-one in the private sector would come forward with a solution, but, in the long term, secure markets and good prospects if the storm could be weathered. He would envisage returning the firm to the private sector in a few years, and said that the professional advice he had taken supported this view.

The decisive factor, however, was the political background in West Belfast. Mackie's was a major employer, drawing from both communities, in an area with 50 per cent male unemployment. The shaky financial position of the company was not perceived by the work force, who would only see that the company was not short of orders. If Mackie were to go to the wall, there would be very awkward parallels with Shorts, where the Government would be seen to have written off £40 million in one year, albeit unwittingly and





retrospectively, for an East Belfast company with a mainly Protestant work force.

As far as the E(A) remit was concerned, your Secretary of State said that he agreed that the Treasury had won the economic argument: it had been accepted that there was absolutely no case for a rescue, on purely economic grounds. However, he felt that the meeting had also given some weight to the particular social and political problems that arose because it was a Northern Ireland company. They had wanted the Treasury to co-operate in finding the "least worst" solution, and ideally, they would have wanted this to take the form of a secured loan. However, this simply could not be done, because of legal problems, and because the Northern Bank had got there first. So your Secretary of State now felt he had to proceed on the basis of his revised proposal. If this could not be sorted out bilaterally with the Treasury, then he would have to return to E(A).

He emphasised the priority he attached to this issue, and that he ~~thought it trickier than~~ either Shorts or Harland and Wolff. At Shorts there would be a difficult time ahead, and there would be redundancies, but he thought the business could eventually get back on track. For Harland and Wolff, he envisaged either a private sector solution, or that the company would simply have to fold. But the situation in West Belfast was particularly sensitive: there was a helpful mood in the community at the moment, and he was not prepared to jeopardise it by allowing Mackie's to go to the wall. If the Chancellor felt able to put to one side his reservations about a rescue on terms other than a secured loan, your Secretary of State said he would value Treasury help in the further work to refine the "least worst" solution.

In reply, the Chancellor said that he agreed that the question was not how we would treat a company in this position anywhere else in the UK: we did have to consider all the circumstances. These included the position which had developed at Shorts, which the Chancellor said he found very disturbing. He was very concerned to learn that the Finance Director at the time was still involved in managing the company. However, he agreed that Shorts might well become a viable business, although in his view the aircraft side of the business might have to go. On Harland and Wolff, he understood that the Secretary of State had for a long time taken the view that closure was the only option. Your Secretary of State said that the priority must clearly be to finish the existing orders. Apart from that, there was the question of Mr Tikoo, and other possible private sector buyers. There was attraction in calling their bluff, indicating the kind of dowry that was available, and giving them a deadline by which they had to respond.

Turning to Mackie itself, the Chancellor said he did not entirely see the parallel with Rolls Royce in 1971. The sums of money at stake in Rolls Royce had been larger, and it was therefore not at





all surprising that the private sector had not come forward with a solution. Also, the Rolls Royce problem had emerged with much less warning, and there had been less time to look around for alternative more acceptable solutions. However, there had been plenty of time to find a private sector rescuer for Mackie, if the firm really was viable, but no-one had expressed interest. This did raise the question of whether the company had a future, or would be forever dependent on public support. Your Secretary of State repeated his view that the problem was a short-term one. Once the necessary modernisation programme had been effected, and the management team strengthened, it should be viable. The Chancellor said that if it really was a short term problem, then this might be another case for offering a dowry if a reputable firm were prepared to take the company on. This would meet the Chancellor's particular concern that to proceed as earlier proposed by Mr King, i.e. without a secured loan, would effectively renege on the assurances we had given the PAC after deLorean. Thought would still need to be given to the practicalities of a "dowry" solution, and to the guarantees that we would require of the buyer. The Chancellor said that he would envisage the company been put out to a sort of reverse tender - with the lowest dowry bidder winning. The key points of the existing corporate plan could be written into the contract, with clawback penalties if the buyer did not conform to the conditions of the plan.

It was agreed that, compared with the earlier revised proposal, this was an attractive option and the practicalities should be considered urgently by officials.

I am copying this letter to Jeremy Heywood in the Financial Secretary's Office.

Yours,

Moir.

MOIRA WALLACE  
Private Secretary





A large, stylized handwritten signature in the top right corner of the page.

FROM: J M G TAYLOR

DATE: 23 May 1988

PS/FINANCIAL SECRETARY

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  
Mr C Jenkins (OPC)  
Mr Battishill  
Mr Isaac  
Mr Painter  
Mr Lewis  
Mr Fraser  
PS/IR

**TAXATION OF SEAFARERS**

The Chancellor has seen Mr Lewis' note of 18 May, enclosing a further note by Mr Fraser. He awaits the Financial Secretary's views.

2. The Chancellor has asked whether other countries that give favourable tax treatment to their seafarers confine it to their own ships, or whether it is applied to all ships. I should be grateful for advice.

A smaller handwritten signature or initials at the bottom of the page.

J M G TAYLOR





FROM: FINANCIAL SECRETARY  
DATE: 24 May 1988

CHANCELLOR

cc Mrs Case  
Miss Hay  
Mr Tyrie  
Mr Isaac IR  
Mr Lewis IR  
Mr Fraser IR  
PS/IR

**TAXATION OF SEAFARERS**

I have had a further look at this in the light of the figures outlined in Mr Lewis' minute of 18 May and Mr Fraser's minute of the same date.

2. The first point to bear in mind, of course, is that we have no idea how reliable these figures are.

3. even if we accept the figures at face value, it is clear relaxing the rules for the 100% foreign earnings deduction is unlikely to be a very satisfactory way of easing the defence problem confronting us.

What the relaxation will achieve

4. The D.Tp/GCBS figures suggest (ignoring behavioural effects) that the proposed relaxation may take out of tax:

- (i) 2,000 of the 4,000 seafarers in the deep-sea trades for whom PAYE is currently not operating;
- (ii) 5,000 of the 8,000 seafarers for whom PAYE is operating but who are not covered by the existing deduction.

5. Thus, it is certainly fair to say that the proposed relaxation will mitigate the effects of re-introducing PAYE (Of the remaining 2,000 seafarers affected, 1,000 would already be covered by the existing foreign earnings deduction). It would also help 5,000 or so seafarers who currently are paying tax under PAYE.



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Broader Effects

6. What is far from clear, however, is what this will do to solve the "defence problem":

- (i) We do not know whether the seafarers benefitting are on the type of ships in short supply;
- (ii) Even if they are, we have no guarantee that exempting the seafarers from tax will feed through into lower costs for the shipping companies;
- (iii) To the extent that costs are reduced, we have no idea whether this will be sufficient to discourage further flagging out or, still less, to encourage re-flagging of ships currently off the UK register.

7. In short, although the D.Tp/GCBS figures allow us to estimate, crudely, what the direct impact of the proposal would be and how much it would cost, they do not facilitate a proper evaluation of the proposal.

8. My instinct is that this indirect approach to helping the shipping companies is likely to be considerably less effective and certainly less cost-effective than a direct subsidy. The latter route would allow us to target the subsidy on the shipping companies themselves rather than on the seafarers they employ. It would also allow us to target any money on the particular companies or ships most relevant to the defence issue (eg. we could give a subsidy to owners of product tankers who kept their ships on the UK register).

9. In addition to these serious questions about how effective a tax relief would be, there are of course the familiar arguments of principle - inconsistency with general tax policy; possible repercussions and so on.



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'British Ships' Restriction

10. There is the further question of whether any relaxation of the foreign earnings deduction should be confined to "British" ships. I find the Revenue's argument against this proposition very persuasive:

- (i) Very few UK seafarers working on foreign ships are actually paying tax at present, and therefore not extending the relief to foreign ships would make little difference in cost terms, but
- (ii) confining the relief to British ships might raise EC difficulties;
- (iii) and it would make the relief far more complicated and uncertain in its effects.

Handling

X ( 11. Despite my considerable reservations about this proposal, I assume that we now need to work up a paper to send to No 10 covering not only this, but also the BES extension and the original option (a) in Mr Lewis' note of 6 May. I believe the paper should explain why option (a) is a complete non-starter, and should present persuasively the disadvantages of the current proposal. But I think we should - if the timetable permits - hold back from circulating your paper until we have seen what D.Tp propose to say on spending subsidies, since you might want to argue that a public spending subsidy would be, on all counts, preferable to the best of the tax options we have been able to identify or otherwise to comment on D.Tp's proposals.

*g.n.*

*N* NORMAN LAMONT



CONFIDENTIAL

From: THE PRIVATE SECRETARY

*pp*



NORTHERN IRELAND OFFICE

WHITEHALL

LONDON SW1A 2AZ

- 1. *Jarman* ("how interesting!")
- 2. *ppp*

Moira Wallace  
 Private Secretary  
 Chancellor of the Exchequer  
 Treasury Chambers  
 LONDON

CH/EXCHEQUER	
REC.	24 MAY 1988
<del>NOV 1988</del>	
COPIES TO	CST, EST, PMG EST, SU P Middleton Mr Anson, Mr Phillips Mr Monck, Miss Pearson Mr Burgner, Mr Waller  Mr A M White Mr Sharatt Mr Call

*Valley* 24 May 1988

*Dear Moira*

**JAMES MACKIE**

My Secretary of State was grateful for the prompt and full record of his meeting with the Chancellor which you circulated on 19 May.

He has asked me to correct one point in the third paragraph. My Secretary of State did not say that "finding the money was not a problem". He stressed that finding the money was his problem, ie that, as the sentence goes on to state, he would accommodate it within his Block.

I would be grateful if you would amend this sentence accordingly.

I am copying this letter to Jeremy Heywood in Mr Lamont's Office.

*yours*

*Martin*

M E DONNELLY

CONFIDENTIAL

SMN2954





FROM: J M G TAYLOR

DATE: 25 May 1988

PS/FINANCIAL SECRETARY

cc Mrs Case  
Miss Hay  
Mr Tyrie

Mr Isaac - IR  
Mr Lewis - IR  
Mr Fraser - IR  
PS/IR

**TAXATION OF SEAFARERS**

The Chancellor has seen the Financial Secretary's note of 24 May. He agrees that a paper should now be prepared along the lines suggested by the Financial Secretary - though it should not be too negative about the 100 per cent relaxation and the BES change.

A handwritten signature in dark ink, appearing to be 'J M G Taylor'.

J M G TAYLOR





## Inland Revenue

Policy Division  
Somerset House

FROM: I FRASER

25 MAY 1988

PS/FINANCIAL SECRETARY

## TAXATION OF SEAFARERS

1. Mr Taylor's note of 23 May asked whether other countries that give favourable tax treatment to their seafarers confine it to their own ships, or whether it is applied to all ships. Our information is incomplete on this point and the overall picture is not entirely clear.

## OTHER COUNTRIES

(a) EC Countries

2. EC countries with special tax regimes for seafarers consist of Greece, the Netherlands and Denmark. Greece has for many years, going back prior to EC entry, exempted the earnings of ratings and applied a special low rate of tax to officers' salaries. We have been unable to establish

cc PS/Chancellor  
PS/Chief Secretary  
PS/Paymaster General  
PS/Economic Secretary  
Sir P Middleton  
Mr Scholar  
Mrs Case  
Mr Revolta  
Ms Sinclair  
Mr A R Williams  
Mr Cropper  
Mr Tyrie  
Mr Call  
Mr C Jenkins (OPC)

Chairman  
Mr Isaac  
Mr Painter  
Mr Beighton  
Mr Lewis  
Mr McGivern  
Mr Cleave  
Miss Rhodes  
Mr Keith  
Mr R H Allen  
Mr O'Brien  
Mr Fraser  
Mr Alpe  
Mr I Stewart  
Mr K Allen  
Mrs C Williams  
PS/IR



whether employment has to be on Greek ships. In the Netherlands, seafarers subject to a withholding tax on wages are entitled to a special seamen's deduction if they are in the service of a Netherlands company and on a ship with a Netherland home port. We do not know when this regime was introduced but do know it has existed since at least 1975. Denmark has, for many years, had a special regime for seafarers. Prior to the recent Danish election, proposals for a new more favourable tax regime for seafarers were under discussion but it is not yet clear whether and, if so, when this will be implemented.

(b) Other Countries

3. Outside the EC, Norway has for many years given special tax treatment to seafarers employed on Norwegian ships and ships chartered to Norwegian shipping enterprises. (This latter condition reflects the general rule that if the ship is bareboat chartered, it flies the flag of the country of the charterer). In addition, the new Norwegian International register introduced last year, with relaxed rules on the use of foreign crews, includes some tax concessions. Finland grants some allowances from sea employment income and an extra allowance for each month on board a ship in cross trade between foreign ports. One recent report suggests that, in practice, such ships are nearly all foreign flagged.

PRACTICALITIES

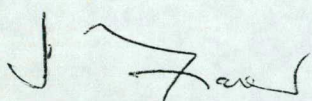
4. It may be helpful if I explain, very briefly, the complications which would arise if the possible relaxation of the foreign earnings deduction rules was limited to British ships.

5. Entitlement to the foreign earnings deduction depends on a person's absence from the UK for any consecutive period of 365 days (not necessarily related in any way to the tax year). Visits to the UK within such a period,



provided they are less than 62 consecutive days or, more importantly, less than 1/6 of the total period under review do not count to disallow the relief. Option b. would provide a more relaxed regime than this (90 days and 1/4) but, if limited to seafarers working on UK registered ships, would mean that seafarers could simultaneously qualify for exemption under one of two similar rules depending on the registration of their ships. (An example is set out in the Annex).

6. Not only is it difficult to see what would be the fairest rules to devise to deal with situations where seafarers have some voyages on non-British ships, this added complexity would make it more difficult to establish in advance which seafarers would benefit from the relaxed rules. This, in turn, would make it even less likely that the benefit would be reflected in lower crew costs for the shipping companies.



I FRASER



Example Seafarer has the following pattern of absence from UK.

	<u>Abroad</u>	<u>UK</u>	<u>Abroad</u>	<u>UK</u>	<u>Abroad</u>	<u>UK</u>	<u>Abroad</u>
<u>Days</u>	80	35	70	30	65	25	70

Of the 375 day period, 90 days have been spent in the UK and throughout the period the 1/4 rule would be satisfied but the 1/6th rule would be satisfied only in relation to the part consisting of the last two voyages and the visit between. If the third trip was on a foreign flagged ship (or during the trip it reflagged to a foreign register) the pattern would be broken and rules would be needed to decide what the effect of this would be.

#### Possible rules

1. Voyage on foreign flagged ship ends cumulative period of absence for purposes of "1/4 rule". If 365 days total not reached, no relief due. Period then reviewed to see if "1/6 rule" applies. If not, no relief due. Next potential 365 day period using 1/6 rule can start with foreign flag voyage. Next period using 1/4 rule starts with next UK flag voyage.
2. Count period on foreign flag ship as not abroad for this purpose - might enable a few to qualify if foreign flag voyage was very short. But this rule would be highly artificial.
3. Relax 365-day rule - this would be a major relaxation and potentially repercussive.



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

0000007

Rt Hon John Major MP  
Chief Secretary  
HM Treasury  
Parliament Street  
LONDON  
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Department of  
Trade and Industry

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Direct line 215 5147  
Our ref  
Your ref  
Date 31 May 1988

CHIEF SECRETARY	
REC.	- 1 JUN 1988
NAME	Mrs Brown
INITIALS	CX Mr Anson Mr Monck
	Mr Bugner Mr Moore
	Mrs Pearson Mr Turnbull
	Mr AM White Mr Waller
	Mr Richardson Mr Call.
	Mr Potter Mr SN Wood.

*Dear John,*

**BRITISH SHIPBUILDERS: FINANCING REMEDIAL MEASURES**

Thank you for your letter of 17 May.

I am sorry you are not able to proceed on the basis I had thought we had agreed for 1988-89. In view of the reduced level of expenditure now expected for that year - and the figures may be even lower than those mentioned in your minute - I can reluctantly agree to contribute to some enterprise measures in addition to advance factory provision, so long as Malcolm Rifkind is prepared to do the same for measures for Scotland. However it is essential that I should have a cash ceiling for my Department's contribution, and that any excess should be met from the Reserve. In view of the prospects of reducing the scale of expenditure in 1988-89 from that previously forecast, I propose that the ceiling on my Department's contribution should be set at £4 million.

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

KENNETH CLARKE



BF 3/6

*5 p.m. Williams  
He will draft*

FROM: A R WILLIAMS  
DATE: 1 June 1988

- 1. MR REVOLTA
- 2. CHANCELLOR

- cc
- Financial Secretary
  - Chief Secretary
  - Sir P Middleton
  - Mr Anson
  - Mr Phillips
  - Mrs Case
  - Miss Hay
  - Miss Barber
  - Mr Tyrie
  - Mr Isaac IR
  - Mr Lewis IR
  - Mr Fraser IR
  - PS/IR

*Annex A*  
*Ch. Annex A*  
*Options to opt in (i)*  
*Options to opt in (ii)*  
*What we proposed?*  
*Per Mr Phillips*  
*Annex A*  
*acc...*

**MERCHANT SHIPPING AND DEFENCE**

Following the Financial Secretary's minute to you of 24 May on the taxation of seafarers, and your comment on it, we have, in consultation with the Revenue, drafted the attached paper for you to send to the Prime Minister. It takes the form of two annexes dealing with the personal taxation options and a covering note which argues that a direct subsidy would be better than a tax relief. We have seen a draft of Mr Channon's paper on a possible subsidy arrangement (copy attached). Although we have doubts about the proposal, which we will bring out in the briefing for the meeting, it is nevertheless likely to be more cost effective than anything which could be devised by way of a tax relief. We do not think that it would be appropriate for you to endorse Mr Channon's specific proposal in your note (apart from any other consideration, the final version of Mr Channon's paper is unlikely to be available until after you have had to write) but in the light of what we have seen so far, a general expression of preference for subsidies as against tax reliefs would be justified.

2. Mr Channon's paper is also likely to have a covering note. DTP officials think that he may wish to argue in it for both a subsidy and a tax relief.

*A.R. Williams*



CONFIDENTIAL

DRAFT

PRIME MINISTER

## MERCHANT SHIPPING AND DEFENCE

1. At our meeting on 4 May it was agreed that I should consider the possibility of introducing new tax reliefs for seafarers. I was asked to look at two options in particular:

(i) To deem British seafarers crewing ships flagged in the Isle of Man or the Channel Islands (the Crown Dependencies) to be domiciled in those islands.

(ii) To relax the rules governing seafarers eligibility for the 100% foreign earnings deduction.

2. The first option is discussed in Annex A. As formulated it would not work. Any workable variant would be repercussive, in clear conflict with our general tax policy, and would not meet our main objectives. I recommend that we firmly reject it.

3. The second option is considered in Annex B. This would provide a workable scheme, which could be brought into operation quickly at limited cost and which would provide an offset for the majority of those who would otherwise start to pay tax on the reintroduction of PAYE. It would also give relief to a substantial number of UK seafarers in the deep sea trades who are currently still paying UK tax.

*Unlike option (i), it has been ~~strongly~~ advocated as part of the GCBS.*



4. But as a measure for dealing with the problem of securing an adequate supply of merchant ships in wartime it suffers from some very serious disadvantages:

- There is no guarantee that exempting seafarers from tax will feed through into lower costs for shipping companies, and hence discourage flagging out.
- It would not be focused on the types of ships which are in short supply for defence purposes. Much of the cost of the relief might therefore be wasted.
- To the extent that shipping costs are reduced, we have no idea whether the reduction will be more or less than is needed to discourage further flagging out and to encourage re-flagging of ships currently off the UK register.

5. In short a seafarer tax relief would have a limited and uncertain effect on shipping companies' costs with no assurance whatsoever that it would contribute more than marginally, if at all, to our defence objectives.

6. While for obvious reasons I have no enthusiasm for subsidies, they do in the present case at least offer the prospect of a better targetted policy, producing guaranteed results if we can put the shipping companies under contractual obligations. In particular they could be:

*Explicit*



- paid directly to shipping companies, thus definitely reducing their costs by the full amount of government assistance
- related specifically to classes of ships in short supply
- fixed only at the level necessary to increase (or maintain) the number of UK registered ships available for defence purposes.

7. We agreed at our last meeting that we should use either tax reliefs or subsidies to ensure that we could meet our wartime shipping requirements. A workable tax relief scheme can be devised. However tax relief schemes seem very unlikely to be as cost effective an approach as a specifically targetted subsidy. We would, of course, have to be satisfied that the latter was permissible under EC rules. Subject to looking at Paul Channon's proposals in detail, I recommend that we should not pursue the tax relief scheme.

8. There is, however, one small tax concession that I propose we offer to the shipping industry. It involves the Business Expansion Scheme (BES), which gives income tax relief to an individual who subscribes for ordinary shares in an unquoted company. The company can carry on a wide range of activities, including shipping. The Finance Bill introduces a general £500,000 limit on the amount of BES finance which can be raised by a company in any year. But for companies letting ships on charter the limit is £5 million.



I propose that the Finance Bill be amended to allow this, higher, limit to apply also to a company which operates its own ships. Although we cannot be sure that the ships involved would be of the kind that would help meet our defence needs, this concession would be a signal to the industry that we have its interests in mind.

9. I am copying this minute to Geoffrey Howe, Douglas Hurd, George Younger, David Young, Kenneth Clarke, and Paul Channon, and to Sir Robin Butler.



**TAX RELIEF FOR CREWS OF SHIPS REGISTERED IN THE CROWN DEPENDENCIES**

1. To deem a British seafarer to be "domiciled" in one of the Crown Dependencies (as suggested at our last meeting) would be of little advantage to him if in fact his home and family were in the UK. In certain limited circumstances he would only be taxed on a remittance basis, but if he lived in the UK he would probably have to remit all, or virtually all of his earnings in any event. "Residence" rather than "domicile" is the relevant concept to consider. A seafarer who was non-resident in the UK would be liable for tax only on earnings which for tax purposes are treated as performed in the UK.

2. However, if relief from UK income tax for the overseas earnings of UK seamen on ships registered in the Crown Dependencies were to be offered, it would be better to go for an explicit exemption rather than to try to achieve the same result indirectly through a deemed non-residence rule. Such a rule would be highly artificial and difficult to operate. Residence is a concept which essentially works by reference to the whole tax year. A seaman may be employed for a shorter or longer period on a Crown Dependency registered ship, with this work interspersed with periods of unemployment, work ashore, or on ships registered elsewhere. Thus a non-residence rule would be complex, arbitrary and uncertain in its effect.



3. The simpler, more direct proposition would be to exempt IOM tax earnings related to periods of duty on a ship registered in a Crown Dependency or Dependent Territory. As it stands this would be both too wide and too narrow. It is too wide because it would exempt the earnings of seamen working on, for example, Isle of Man registered ferries operating in home waters. It is too narrow because it would discriminate against UK registered ships and provide a further incentive for shipping companies to transfer vessels from the UK to the IOM register. To make any sense, the exemption would have to relate to periods of duty on overseas voyages ~~only~~ of both UK and Crown Dependency/Dependent Territory registered ships.

4. Such a tax exemption would be undesirable for the following reasons:

- It would conflict with the Government's general tax policy of sweeping away special reliefs and tax shelters and going for across-the-board reductions in tax rates. It would also be open to EC challenge.

- It would ~~give~~ <sup>be likely representative, given</sup> rise to similar claims from other industries. The taxation of air crew and seamen has usually gone hand in hand. Other industries hard pressed by competitors with low third world labour costs could be expected to advance similar "national interest" arguments for tax relief. There would inevitably be <sup>adverse</sup> pay and taxation comparisons with Royal Navy personnel. also



- For the reasons discussed in paragraph 4 of the covering note, it would be ineffective in securing our wartime shipping needs.



## RELAXING THE RULES FOR THE FOREIGN EARNINGS DEDUCTION

1. This Annex looks at the possibility of relaxing, for British seafarers, the rules governing the 100% foreign earnings deduction.

Present rules

2. This relief was introduced in the mid-1970s, when tax rates were much higher, to help British exporters. The basic rule is that where the duties of an employment are performed wholly or partly abroad, and there is a "qualifying period" of at least 365 days, the pay attributable to that period is exempt from UK tax.

3. A qualifying period has to consist essentially of days outside the United Kingdom, but where there are spells here between periods when duties are performed overseas they can still count towards a qualifying period provided they are not longer than 62 days or 1/6th of the total period.

Possible Relaxation

4. One possibility for relaxing the rules would be to extend the 62 day period which can be spent in the United Kingdom to 90 days, making a corresponding increase in the fraction from 1/6th to 1/4. This is a proposal which the GCBS themselves have raised in Budget Representations in the last year or two.

5. It would be for consideration whether the extended relief should be limited to time served on British ships. There is an obvious presentational point in favour of that. But in practice it would make little difference since for one reason or another British seamen on foreign ships pay little UK tax. It would greatly complicate the operation of the relief making it more difficult for seamen to understand and to be certain that they would qualify. And confining the relief to British ships might raise EC difficulties. On balance, it would probably be better not to restrict the relief to British ships.

6. An extended relief of this kind would not present any legislative or operational difficulty. The Revenue are already planning to discuss with the shipping companies whether the administration of the foreign earnings deduction for seafarers can be simplified.

Effect

7. With help from the Department of Transport the Revenue have been able to make a very broad estimate of what the effect of this change might be on the 15,000 UK seafarers in the deepsea trades

- of the 4,000 for whom PAYE is not at present operating, approximately 1,000 are exempt under the present rules, and a relaxation of this kind would probably exempt another 2,000



- of the 11,000 for whom PAYE is still operating, about 3,000 are already exempt and this relaxation would exempt another 5,000
- the cost would be of the order of £15m to £20m.

8. These figures are not only broad estimates, but also take no account of behavioural effects. To the extent that seafarers arranged for the pattern of their voyages to be changed so that they came within the relaxed rules - this is already happening to some extent with the present rules - the numbers qualifying for exemption, and the cost, would increase.

#### Evaluation

9. On the one hand, a relaxation

- would fairly comprehensively offset the reintroduction of PAYE, and in addition give relief to a substantial number of UK seafarers in the deepsea trades who are currently still paying UK tax
- would respond to a specific GCBS suggestion.

10. On the other,

- it would run counter to the main thrust of tax policy which has been to accompany reductions in tax rates with the restriction of special tax shelters; and since other occupations (such as airline staff and consultants working abroad) benefit from the present relief there would be pressure to make the relaxation apply generally, at additional cost
- any financial benefit to the shipping companies (and thus inducement to retain ships on the British register) would be indirect and imprecise, since there would be no mechanism for ensuring that the seafarers' reduced tax liabilities were reflected in lower pay levels which reduce the shipping companies' crewing costs. (The GCBS have themselves commented that some mechanism would be needed - they have not been able to specify one - if their balance sheets were to benefit from reduced seafarers' tax liabilities)
- insofar as shipping companies benefit indirectly, it might be in respect of any class of ship, not only the types required for defence purposes
- because the relaxation would affect the shipping companies indirectly and generally, and without any commitment on their part, it could not be guaranteed to deliver any improvement - or even the maintenance of the present position - in the supply of ships required for defence purposes.



# CONTRACTING FOR MERCHANT SHIPPING

## DEFENCE REQUIREMENTS

### PAPER BY THE SECRETARY OF STATE FOR TRANSPORT

#### Introduction

1. The Prime Minister's meeting on Merchant Shipping on 4 May invited the Chancellor of the Exchequer and the Secretary of State for Transport to work up, in more detail, schemes for ensuring that the United Kingdom's wartime requirements could be met. This paper examines the option, discussed at the meeting, for a scheme of contractual arrangements with owners of vessels in short supply to secure their availability in time of emergency.

#### Current Requirements

2. The United Kingdom has a wartime requirement for merchant shipping for military support and for civil resupply. To meet the requirement we rely on powers to requisition vessels on the British register or vessels owned by United Kingdom interests and operated on foreign registers. Ships engaged in direct support of defence forces should be registered in the United Kingdom or Isle of Man and manned by crews acceptable in terms of security. For vessels engaged in civil resupply the flag of registry and the crewing arrangements are less important. But to avoid our having to rely on the market to provide sufficient vessels it is important that sufficient vessels should be subject to requisitioning. In practice there is a gradation of availability from UK registered ships which almost all have British crews, through ships registered on dependent territory registers, which may well have mixed crews, to ships on foreign registers with foreign crews working in foreign waters. This is illustrated in respect of product tankers in Table 2. To ensure that the



Government's requirements can be met it is important therefore that sufficient vessels of particular types are maintained on the United Kingdom and wider British registers.

### Objectives

3. The objective of the contract scheme would be to ensure that the Government had access to an adequate supply of particular types of vessel in order to meet defence and civil resupply requirements. This would be done by:

- (i) ensuring that British flag vessels already easily available remained so;
- (ii) providing an incentive for vessels directly or indirectly owned by UK companies, whose place of registry and crewing arrangements made them less easily available, to transfer to registers and crewing arrangements which made requisitioning easier;
- (iii) to encourage existing or new UK owners (including non-UK owners who become UK owners) to make additional ships available.

### Coverage

4. The scheme could in theory be used for any particular class of ship but it is more appropriate for those types where there is a general and continuing demand in world markets. The category which demands immediate attention for defence requirements is that of product tankers. On the latest projections there is a very fine balance between available supply and demand for military and civilian resupply. Demand for product tankers of 10-80,000 dwt has been critically re-examined to reflect latest thinking by the Department of Energy and is estimated at a minimum of 121 (28 for military and 93 for civil purposes).



5. Total current supply is 122 vessels. At present, and assuming the continuing attractiveness of the Isle of Man register, there is no shortage of vessels on the UK and Isle of Man register to meet military requirements. But the position as far as civil resupply is concerned is less satisfactory. The supply figures assume that all vessels which are owned either directly or indirectly by UK companies on whatever register can be made available even though some are on registers and operate in areas which would make it difficult to effect a rapid recovery. Allowance is made for reduced operating efficiency in wartime but no allowance is made for loss of cargoes and ships due to enemy action. Future supply may drop for a number of reasons. First there is the uncertain effect of changes in PAYE arrangements for seafarers employed by manning agencies on ships owned by UK companies and registered in the Isle of Man and elsewhere. Secondly, there is competition from other registries being set up to offer tax/social security concessions in eg. *NATO!* Norway, Denmark and the FRG. This could lead to owners deciding to flag outside the UK and dependent territories and to employ foreign crews. To the extent that such movements are to other NATO flag countries they should not diminish the total number of tankers available in the NATO Pool for civil resupply (see para 15). But such movements will deplete the numbers of British crews and this will ultimately have an effect on the core fleet available for military purposes. For these reasons a prudent target for the scheme might be assured availability of 150 tankers.

#### Outline of Schema

6. Shipowners would be invited to contract to maintain product tankers under certain conditions on the understanding that the vessels would be made available to the Government in the event of an emergency.

7. We need further study in consultation with the industry to work out the most economic and reliable set of contract conditions. But it seems clear that the contract would need to control:



- (i) The number, type and size of ships
- (ii) The flag of registry
- (iii) The nationality/certification of the crew
- (iv) The availability of the vessel
- (v) The duration of the obligation.

It would be possible to vary the type of contract according to need. If the UK and Isle of Man registers were to decline substantially we might need to contract for tankers needed for direct support of defence forces, in which case we would envisage stringent conditions specifying a United Kingdom or Isle of Man registry and at least all UK officers. We might also need to specify availability in geographical terms eg. at a UK Port within fifteen days.

8. The immediate requirement is, however, for tankers to be used for civil resupply. For these it should be enough to specify:

- United Kingdom, Crown Dependency or Dependent Territory registration
- UK senior officers
- Availability after completion of current voyage.

#### Cost

9. A key feature to keep down public expenditure would be competitive tender. Owners would be invited to submit bids for the compensation payment which they would require to operate ships under the conditions specified in the contract. The use of competitive tendering should ensure that the level of subsidy is set at the minimum necessary to achieve the objectives of the scheme. But there will inevitably be some deadweight in the scheme as it would have to cover tankers operating commercially which already meet the requirements of the contract and are available without subsidy. Any attempt to exclude ships already available could be circumvented by owners taking their ships off the register temporarily and then flagging in to benefit from the scheme. There are, however, still strong commercial pressures encouraging owners to flag out and without action we would expect the drift from the UK flag to continue. The availability of the



scheme should therefore encourage owners to stay on the British register who would not otherwise do so and to that extent the subsidy would not be wasted. Moreover, competitive tendering should help minimise the deadweight as shipowners already meeting the requirements of the contract commercially could be expected to submit lower bids.

10. The total cost of the scheme will depend on the conditions attached to the contract, in particular the degree of difference between the cost of crews operated on a commercial basis and those required under the contract. For those companies already operating commercially in line with the requirements of the contract a somewhat smaller amount than the actual difference in costs would be required. For product tanker of 40,000 dwt currently operating on a foreign register with a third world crew the additional crew cost of transferring to a dependent territory register and operating with UK senior officers is estimated as £50,000 per annum. Transferring to the Isle of Man register and employing a full UK crew on an offshore agreement would raise this figure to £200,000 per annum. We think most operators would find it unsatisfactory to re-crew with UK senior officers without at least employing British (or Commonwealth) junior officers, though they could be more flexible as regards the nationality of ratings. An average re-crewing cost would therefore be around £100,000 per vessel per annum. In addition we would expect to have to pay an annual premium to cover associated administrative and organisational costs of operating on the British register and an element for profit as shipping companies would be unlikely to accept the contract at cost price. This might add about 30% to the simple crew costs. For a requirement of 150 vessels on a less restrictive contract the total cost would therefore be of the order of £20m per annum (150 vessels at £130,000 (£100,000 crew costs + £30,000 premium) = £19.5m)

#### Legislation

11. The scheme would require primary legislation.



Assessment

12. The advantage of the scheme as outlined is that it provides a method of targetting subsidy most accurately at the specific categories of shipping where our needs are most urgent.

13. The scheme is intended to have a twofold effect on the supply of vessels in an emergency - to make those already available more readily available and to attract additional tonnage into the pool of available vessels. There are a number of tanker owners, both oil majors and independents on the UK register eg. Cunard, Canadian Pacific, Furness Withy, Maersk, Swire, Silver Line, BP, Shell etc., who might find it attractive to expand again under the terms of a subsidy contract. However, the degree to which the oil majors would be willing to transfer ships from other registers/direct ownerships may be constrained by the operational requirement to have them flagged and/or owned in certain countries eg. Shell Argentina. There are also other possible sources of ships which already have links with the UK - eg. ships managed or owned by Hong Kong interests (eg. World-wide Shipping) or Greek shipowners based in London - who may also be attracted by the scheme.

14. The effectiveness of the scheme might therefore be assessed by the extent to which it encouraged the switch of existing UK owned vessels from less to more desirable registry and manning arrangements as well as the extent to which it increased the total pool of product tankers available.

15. The effect of the scheme on the number of vessels available for civil resupply, for which NATO resources are pooled, needs to be considered in a NATO context. The scheme will only increase the number of vessels available to the extent that it adds to the pool of vessels firmly available to all NATO countries. On the assumption that pooling arrangements operate as planned there would be no value in movements within the NATO pool. The matrix at Table 3 summarises the present supply position of tankers which could carry products. The proposed scheme would need to encourage non-NATO owners to consider making their vessels available for UK needs by becoming British owners. There are a



number of owners with vessels on open registers, especially those owners in Hong Kong, which might be potential bidders. But it is inevitable that some of the movements generated by the scheme -while bringing more vessels under the UK umbrella - will not bring any improvement to the overall civil resupply situation. On the other hand, if other NATO governments follow our example and contract with their owners on a similar basis, the pool will be further enhanced.

16. The effectiveness and cost of the scheme will also depend on the general attractiveness to shipowners of operating on the British register and particularly the ease of employing British crews. Impending shortages of British junior officers might make it difficult for owners to take advantage of the scheme even if they wanted to. And decisions on the personal taxation of seafarers will also clearly influence the likely attractiveness of the scheme.

#### Political Reactions

17. I would expect the scheme to be widely welcomed in Parliament and outside. There would be pressure for early legislation to give it effect. We would clearly have to resist Opposition pressure to use the scheme to secure protected employment for British ratings on NUS terms.

18. We would need to handle the scheme carefully in international organisations. The European Commission have been under pressure to come forward with ideas for 'positive measures' to help Community fleets, and there will, rightly, be concern that a proliferation of different schemes of assistance in Member States could be counter-productive. In general terms, any form of assistance to the shipping industry will weaken our position in arguing against protectionism. But a scheme that was very clearly tied to our strategic requirements would be less damaging to that cause and should be proof against any action under the state aids provisions of the Treaty of Rome.



Conclusion

19. The next step would be to work up full details of the scheme, in particular the terms of the contract and the ways in which competition can be maximised, with a view to having the scheme in place to use, as necessary, to secure the supply of particular types of vessel.



TABLE 1

Vessels on the UK register (incl. IOM) defined as Tankers  
10- 80,000 dwt

<u>End 1984</u>	<u>End 1986</u>	<u>End March 1988</u>
129	64	73

Notes Figures include privately owned and MOD owned RFA vessels and 2 vessels, Altanin and Wenjiang, which are Gulf casualties. All figures include gas tankers; in 1988 there were 6 gas tankers in the size range 10-80,000 dwt. Thus the figure of 67 vessels able to carry products; this is divided between Mainland and IOM as 31 and 36 respectively.



TABLE 2

Distribution by Register of UK Owned Vessels available to carry Products

UK Mainland	31	
-IOM	36	
Sub Total		67
Bermuda	11	
Cayman	3	
Gibraltar	3	
Hong Kong	18	
Sub Total		35
Other Registers		20
Grand Total		122

Notes 1. Figures include RFAs.

2. Figures exclude Shell vessels in Argentina and Australia - assumed not to be available for UK purposes. Other registers made up of 14 Liberia, 3 Bahamas, 2 Panama, 1 Malta.



TABLE 3

## NATO flag/NATO Ownership

UK/UK	31
IOM/UK	36
-----	
Greece/ Greece	86
US/US	133
Denmark/Denmark	24
Italy/Italy	72
Norway/Norway	20
Turkey/Turkey	10

## Semi NATO flag/ NATO ownership

Bermuda/UK	11
Cayman/UK	3
Gibraltar/UK	3
Hong Kong/UK	18
-----	
Cyprus/Greece	39

## Non- NATO flag / NATO ownership

Other Commonwealth/ UK	3
Other/UK	17
-----	
Liberia/Greece	16
/Netherlands	7
/Norway	19
/US	56
Malta/Greece	24
Panama/Germany	2
/Greece	16
/US	2
Singapore/Belgium	5
/Norway	6
/US	3
Bahamas/US	10
/Denmark	5



Non NATO flag non NATO ownership

Liberia/Hong Kong	26
/Indonesia	21
/Japan	27
/Kuwait	6
Panama/Hong Kong	8
/Indonesia	14
/Japan	34
-----	
Algeria/Algeria	5
Arab Emirates/A E	12
Argentina/Argentina	21
Brazil/Brazil	34
Ecuador/Ecuador	7
India/India	37
Indonesia/Indonesia	19
Iran/Iran	12
Iraq/Iraq	7
Japan/Japan	32
Korea/Korea	7
Mexico/Mexico	28
Saudi Arabia/Saudi Arabia	11
Singapore/Singapore	12
Spain/Spain	16
Venezuela/Venezuela	17

Others

Finland/Finland	13
Sweden/ Sweden	9
-----	
PRC/PRC	70
-----	
WP/WP	209



FROM: A R WILLIAMS  
DATE: 2 June 1988

PS/CHANCELLOR

cc Financial Secretary  
Chief Secretary  
Sir P Middleton  
Mr Anson  
Mr Phillips  
Mrs Case  
Miss Hay  
Miss Barber  
Mr Tyrie  
Mr Isaac IR  
Mr Lewis IR  
Mr Fraser IR  
PS/IR

*Ch. / What Mr Williams has done is spell out in Annex A those arguments which are repeated in Annex B. This makes for slightly boring readings but since we are talking about Annexes is not a major problem.*

*Content? 25 2/6 Cuthbert*

**MERCHANT SHIPPING AND DEFENCE**

As requested I attach a redrafted Annex A, emphasising more strongly and setting out more explicitly the objections to the tax option discussed, so that the disadvantages of this option do not appear less extensive than those to the alternative in Annex B.

*A.R. Williams*

A R WILLIAMS



**TAX RELIEF FOR CREWS OF SHIPS REGISTERED IN THE CROWN DEPENDENCIES**

1. To deem a British seafarer to be "domiciled" in one of the Crown Dependencies (as suggested at our last meeting) would be of little advantage to him if in fact his home and family were in the UK. In certain limited circumstances he would only be taxed on a remittance basis, but if he lived in the UK he would probably have to remit all, or virtually all of his earnings in any event. "Residence" rather than "domicile" is the relevant concept to consider. A seafarer who was non-resident in the UK would be liable for tax only on earnings which for tax purposes are treated as performed in the UK.

2. However, if relief from UK income tax for the overseas earnings of UK seamen on ships registered in the Crown Dependencies were to be offered, it would be better to go for an explicit exemption rather than to try to achieve the same result indirectly through a deemed non-residence rule. Such a rule would be highly artificial and difficult to operate. Residence is a concept which essentially works by reference to the whole tax year. A seaman may be employed for a shorter or longer period on a Crown Dependency registered ship, with this work interspersed with periods of unemployment, work ashore, or on ships registered elsewhere. Thus a non-residence rule would be complex, arbitrary and uncertain in its effect.

3. The simpler, more direct proposition would be to exempt from tax earnings related to periods of duty on a ship registered in a Crown Dependency or Dependent Territory. As it stands this would be both too wide and too narrow. It is too wide because it would exempt the earnings of seamen working on, for example, Isle of Man registered ferries operating in home waters. It is too narrow because it would discriminate against UK registered ships and provide a further incentive for shipping companies to transfer vessels from the UK to the IOM register. To make any sense, the exemption would have to relate to periods of duty on overseas voyages only of both UK and Crown Dependency/Dependent Territory registered ships.

4. Such a tax exemption would be undesirable for the following reasons:

- It would conflict with the Government's general tax policy of sweeping away special reliefs and tax shelters and going for across-the-board reductions in tax rates. It would also be open to EC challenge.
- It would be highly repercussive, giving rise to similar claims from other industries. The taxation of air crew and seamen has usually gone hand in hand. Other industries hard pressed by competitors with low third world labour costs could be expected to advance similar "national interest" arguments for tax relief. There would inevitably be adverse pay and taxation comparisons with Royal Navy personnel.



- any financial benefit to the shipping companies (and thus inducement to retain ships on the British register) would be indirect and imprecise, since there would be no mechanism for ensuring that the seafarers' reduced tax liabilities were reflected in lower pay levels which reduce the shipping companies' crewing costs. (The GCBS have themselves commented that some mechanism would be needed - they have not been able to specify one - if their balance sheets were to benefit from reduced seafarers' tax liabilities)
- insofar as shipping companies benefit indirectly, it might be in respect of any class of ship, not only the types required for defence purposes
- because the relaxation would affect the shipping companies indirectly and generally, and without any commitment on their part, it could not be guaranteed to deliver any improvement - or even the maintenance of the present position - in the supply of ships required for defence purposes.





*for meeting folder on 8/6*

cc: Financial Secretary  
Chief Secretary  
Sir P Middleton  
Mr Anson  
Mr Philips  
Mrs Case  
Miss Hay  
Miss Barber

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

Mr A R Williams  
Mr Tyrie  
Mr Isaac IR  
Mr Lewis IR  
Mr Fraser IR  
PS/IR

PRIME MINISTER

**MERCHANT SHIPPING AND DEFENCE**

At our meeting on 4 May it was agreed that I should consider the possibility of introducing new tax reliefs for seafarers. I was asked to look at two options in particular:

(i) To deem British seafarers crewing ships flagged in the Isle of Man or the Channel Islands (the Crown Dependencies) to be domiciled in those islands.

(ii) To relax the rules governing seafarers eligibility for the 100% foreign earnings deduction.

The first option is discussed in Annex A. As formulated it would not work. Any workable variant would be repercussive, in clear conflict with our general tax policy, and would not meet our main objectives. I recommend that we firmly reject it.

The second option is considered in Annex B. This would provide a workable scheme, which could be brought into operation quickly at limited cost and which would provide an offset for the majority of those who would otherwise start to pay tax on the reintroduction of PAYE. It would also give relief to a substantial number of UK seafarers in the deep sea trades who are currently still paying UK tax. Unlike option(i), it has been advocated by the GCBS.

But as a measure for dealing with the problem of securing an adequate supply of merchant ships in wartime it suffers from some very serious disadvantages:





- There is no guarantee that exempting seafarers from tax will feed through into lower costs for shipping companies, and hence discourage flagging out.
- It would not be focused on the types of ships which are in short supply for defence purposes. Much of the cost of the relief might therefore be wasted.
- To the extent that shipping costs are reduced, we have no idea whether the reduction will be more or less than is needed to discourage further flagging out and to encourage re-flagging of ships currently off the UK register.

In short a seafarer tax relief would have a limited and uncertain effect on shipping companies' costs with no assurance whatsoever that it would contribute more than marginally, if at all, to our defence objectives.

While for obvious reasons I have no enthusiasm for explicit subsidies, they do in the present case at least offer the prospect of a better targetted policy, producing guaranteed results if we can put the shipping companies under contractual obligations. In particular they could be:

- paid directly to shipping companies, thus definitely reducing their costs by the full amount of government assistance
- related specifically to classes of ships in short supply
- fixed only at the level necessary to increase (or maintain) the number of UK registered ships available for defence purposes.

We agreed at our last meeting that we should use either tax reliefs or subsidies to ensure that we could meet our wartime shipping





requirements. A workable tax relief scheme can be devised. However tax relief schemes seem very unlikely to be as cost effective an approach as a specifically targetted subsidy. We would, of course, have to be satisfied that the latter was permissible under EC rules. Subject to looking at Paul Channon's proposals in detail, I recommend that we should not pursue the tax relief scheme.

There is, however, one small tax concession that I propose we offer to the shipping industry. It involves the Business Expansion Scheme (BES), which gives income tax relief to an individual who subscribes for ordinary shares in an unquoted company. The company can carry on a wide range of activities, including shipping. The Finance Bill introduces a general £500,000 limit on the amount of BES finance which can be raised by a company in any year. But for companies letting ships on charter the limit is £5 million. I propose that the Finance Bill be amended to allow this, higher, limit to apply also to a company which operates its own ships. Although we cannot be sure that the ships involved would be of the kind that would help meet our defence needs, this concession would be a signal to the industry that we have its interests in mind.

I am copying this minute to Geoffrey Howe, Douglas Hurd, George Younger, David Young, Kenneth Clarke, and Paul Channon, and to Sir Robin Butler.

A handwritten signature in black ink, appearing to be 'NL'.

[NL]

3 June 1988



## TAX RELIEF FOR CREWS OF SHIPS REGISTERED IN THE CROWN DEPENDENCIES

1. To deem a British seafarer to be "domiciled" in one of the Crown Dependencies (as suggested at our last meeting) would be of little advantage to him if in fact his home and family were in the UK. In certain limited circumstances he would only be taxed on a remittance basis, but if he lived in the UK he would probably have to remit all, or virtually all of his earnings in any event. "Residence" rather than "domicile" is the relevant concept to consider. A seafarer who was non-resident in the UK would be liable for tax only on earnings which for tax purposes are treated as performed in the UK.

2. However, if relief from UK income tax for the overseas earnings of UK seamen on ships registered in the Crown Dependencies were to be offered, it would be better to go for an explicit exemption rather than to try to achieve the same result indirectly through a deemed non-residence rule. Such a rule would be highly artificial and difficult to operate. Residence is a concept which essentially works by reference to the whole tax year. A seaman may be employed for a shorter or longer period on a Crown Dependency registered ship, with this work interspersed with periods of unemployment, work ashore, or on ships registered elsewhere. Thus a non-residence rule would be complex, arbitrary and uncertain in its effect.

3. The simpler, more direct proposition would be to exempt from tax earnings related to periods of duty on a ship registered in a Crown Dependency or Dependent Territory. As it stands this would be both too wide and too narrow. It is too wide because it would exempt the earnings of seamen working on, for example, Isle of Man registered ferries operating in home waters. It is too narrow because it would discriminate against UK registered ships and provide a further incentive for shipping companies to transfer vessels from the UK to the IOM register. To make any sense, the exemption would have to relate to periods of duty on overseas voyages of both UK and Crown Dependency/Dependent Territory registered ships.

4. Such a tax exemption would be undesirable for the following reasons:

- It would conflict with the Government's general tax policy of sweeping away special reliefs and tax shelters and going for across-the-board reductions in tax rates. It would also be open to EC challenge.
- It would be highly repercussive, giving rise to similar claims from other industries. The taxation of air crew and seamen has usually gone hand in hand. Other industries hard pressed by competitors with low third world labour costs could be expected to advance similar "national interest" arguments for tax relief. There would inevitably be adverse pay and taxation comparisons with Royal Navy personnel.
- any financial benefit to the shipping companies (and thus inducement to retain ships on the British register) would



be indirect and imprecise, since there would be no mechanism for ensuring that the seafarers' reduced tax liabilities were reflected in lower pay levels which reduce the shipping companies' crewing costs. (The GCBS have themselves commented that some mechanism would be needed - they have not been able to specify one - if their balance sheets were to benefit from reduced seafarers' tax liabilities)

- insofar as shipping companies benefit indirectly, it might be in respect of any class of ship, not only the types required for defence purposes
- because the relaxation would affect the shipping companies indirectly and generally, and without any commitment on their part, it could not be guaranteed to deliver any improvement - or even the maintenance of the present position
  - in the supply of ships required for defence purposes.



## RELAXING THE RULES FOR THE FOREIGN EARNINGS DEDUCTION

1. This Annex looks at the possibility of relaxing, for British seafarers, the rules governing the 100% foreign earnings deduction.

### Present rules

2. This relief was introduced in the mid-1970s, when tax rates were much higher, to help British exporters. The basic rule is that where the duties of an employment are performed wholly or partly abroad, and there is a "qualifying period" of at least 365 days, the pay attributable to that period is exempt from UK tax.

3. A qualifying period has to consist essentially of days outside the United Kingdom, but where there are spells here between periods when duties are performed overseas they can still count towards a qualifying period provided they are not longer than 62 days or 1/6th of the total period.

### Possible Relaxation

4. One possibility for relaxing the rules would be to extend the 62 day period which can be spent in the United Kingdom to 90 days, making a corresponding increase in the fraction from 1/6th to 1/4. This is a proposal which the GCBS themselves have raised in Budget Representations in the last year or two.

5. It would be for consideration whether the extended relief should be limited to time served on British ships. There is an obvious presentational point in favour of that. But in practice it would make little difference since for one reason or another British seamen on foreign ships pay little UK tax. It would greatly complicate the operation of the relief making it more difficult for seamen to understand and to be certain that they would qualify. And confining the relief to British ships might raise EC difficulties. On balance, it would probably be better not to restrict the relief to British ships.

6. An extended relief of this kind would not present any legislative or operational difficulty. The Revenue are already planning to discuss with the shipping companies whether the administration of the foreign earnings deduction for seafarers can be simplified.

### Effect

7. With help from the Department of Transport the Revenue have been able to make a very broad estimate of what the effect of this change might be to the 15,000 UK seafarers in the deepsea trades

- of the 4,000 for whom PAYE is not at present operating, approximately 1,000 are exempt under the present rules, and a relaxation of this kind would probably exempt another 2,000
- of the 11,000 for whom PAYE is still operating, about 3,000 are already exempt and this relaxation would exempt another 5,000



- the cost would be of the order of £15m to £20m. X

8. These figures are not only broad estimates, but also take no account of behavioural effects. To the extent that seafarers arranged for the pattern of their voyages to be changed so that they came within the relaxed rules - this is already happening to some extent with the present rules - the numbers qualifying for exemption, and the cost, would increase.

#### Evaluation

9. On the one hand, a relaxation

- would fairly comprehensively offset the reintroduction of PAYE, and in addition give relief to a substantial number of UK seafarers in the deepsea trades who are currently still paying UK tax
- would respond to a specific GCBS suggestion.

10. On the other,

- it would run counter to the main thrust of tax policy which has been to accompany reductions in tax rates with the restriction of special tax shelters; and since other occupations (such as airline staff and consultants working abroad) benefit from the present relief there would be pressure to make the relaxation apply generally, at additional cost
- any financial benefit to the shipping companies (and thus inducement to retain ships on the British register) would be indirect and imprecise, since there would be no mechanism for ensuring that the seafarers' reduced tax liabilities were reflected in lower pay levels which reduce the shipping companies' crewing costs. (The GCBS have themselves commented that some mechanism would be needed - they have not been able to specify one - if their balance sheets were to benefit from reduced seafarers' tax liabilities)
- insofar as shipping companies benefit indirectly, it might be in respect of any class of ship, not only the types required for defence purposes
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FROM: A M WHITE  
DATE: 3 JUNE 1988

FINANCIAL SECRETARY

- cc Chancellor
- Chief Secretary
- Paymaster General
- Economic Secretary
- Sir Peter Middleton
- Mr Anson
- Mr Philips
- Mr Monck
- Miss Peirson
- Mr Burgner
- Mr Waller
- Mr Sharratt
- Mr Call

*Handwritten notes:*  
 R X. of whom Mr K returns to with this proposal, he should make clear to what work he is referring to.

*Handwritten notes:*  
 show of the given by B(A).

JAMES MACKIE & SONS

We have had further discussions with Northern Ireland officials following the Chancellor's meeting with Mr King.

2. Lazards have looked at the feasibility of the Chancellor's suggestion to Mr King that a takeover of Mackie might be arranged by means of a Government dowry. They had previously carried out extensive soundings in an attempt to attract private sector investment in Mackie. We understand that their advice to Northern Ireland officials will be that there will be no takers for a dowry equivalent to the £20m cost of the rescue package proposed by Mr King and that there are only two practical options; either Mackie goes into liquidation or a Government sponsored rescue is mounted.

3. The main advantage of a dowry would be that it could be made to provide for a clean break with further Government involvement and assistance other than that to which Mackie would normally be eligible for. But given Mackie's financial position, Lazards' view is that it would require considerably more than the equivalent of the proposed £20m Government funded rescue package to induce a white knight to take on the risks involved in attempting to return Mackie to profitability. The truth of the matter is that Mr King's bullishness about the company's prospects flies in the face of the private sector's assessment of the commercial risks.

4. It is clear also that a dowry equivalent to the £20m of assistance previously proposed by Mr King, would breach the EC ceiling on assistance in Northern Ireland. This would require the

*by how much?*

*by how much?*



how long? Commission to be notified of the proposals and it is almost certain that in the time it would take to have these approved, Mackie would have gone into receivership.

5. The Northern Irish argue that there are other grave difficulties with a dowry:

- a) a dowry for a company the Government has no interest in would be difficult to defend on grounds of propriety;
- b) the Government has no powers to bring about a forced sale and the procedures for the trustees to dispose of the assets of the company voluntarily would be lengthy and complex;
- c) a clean break would not be possible as there would have to be a contract between the purchaser and the Government in respect of any undertakings the Government required (eg that Mackie's was kept open for a minimum length of time);
- d) the Government might still be liable under insolvency legislation if Mackie's purchaser subsequently failed

X/ 6. Northern Ireland officials are now considering what advice to give to Mr King. This is likely to be that he should return to colleagues with the conclusion that having explored all alternatives, the only option is the package he discussed with you on May 18 and to seek their agreement for that. (He will not of course consider that the liquidation option is open to him on political grounds).

7. Mr White's minute to you of 13 May enumerated the unsatisfactory features of those proposals. In particular, they give rise to the unavoidable risk that the Government would be liable for the company's debts if it failed. The proposals are also deficient in terms of their plans for strengthening the management of the company. While those could not be put into effect until the rescue plan has been agreed and the Government can exercise leverage on the trustees through conditions attached to the offer of assistance, we would expect to see evidence that steps had been taken to identify the weaknesses in the existing management and to find suitable candidates to replace them. Unless suitable appointees are identified before Mr King gets agreement to any rescue package, there is a strong risk that the management will not in fact be suitably strengthened.



8. We have arranged a further meeting with IDB and DFP on Tuesday to consider the advice they propose giving to Mr King in the light of Lazards report. It would be helpful to know if you agree that we should then press them hard on the adequacy with which Lazards have explored the dowry possibility, and stress the need to identify a suitable management team before Mr King approaches colleagues again.

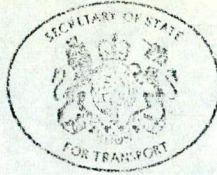


A M WHITE



*BF for meeting [unclear]*

SERIAL NO: 1826  
COPY NO 3 OF 20



Prime Minister

CH/EXCHEQUES	
REC.	03 JUN 1988 ✓3/6
ACTION	MR A R WILLIAMS
COPIES TO	CST, FST, Sir P Middleton Mr Anson Mr Phillips Mrs Case, Miss Hall Miss Barber, Mr Tyme Mr Isaac IR, Mr Lewis IR Mr Fraser IR, PS IR

MERCHANT SHIPPING AND DEFENCE

1. We are due to meet on 8 June to consider what should be done to secure our wartime requirements for merchant shipping.
2. My paper - which I attach - outlines a proposal for a scheme for contracting with shipowners to keep their vessels available. An annex to the Chancellor's paper will, I understand, outline a proposal for relaxing the rules governing tax relief on foreign earnings by seafarers.
3. The two sets of proposals represent different ways of approaching the problem. But they can be seen as complementary; and I believe that both are needed if we are to respond effectively to a problem which we have agreed must be tackled urgently.

Contracting for Defence Requirements

4. The main advantages of contracting by competitive tender to meet our requirements for classes of ship in short supply are that the expenditure can be closely targeted at an identified need. We should be paying no more than we must to achieve our objective of securing the availability of an exact number of vessels.
5. The scheme is also flexible; by changing the terms of the tender and contract it can quickly be adapted to meet any potential shortages which might arise.
6. The disadvantages are that the scheme would be relatively complicated, would require primary legislation, and would take time to implement.



PC  
From



Tax: not better  
used for contract  
scheme.

£15m - £20m

Contract scheme looks  
OK OK -

proper target

head of exam  
agree in principle, the chief  
head of exam detail

? How to apply to shops  
for other NATO countries

? Gov - action open to  
European Committee

? not for work type  
provision.

HMT model in work and  
details.





7. The scheme would do nothing in the short term to offset the impact of the re-introduction of PAYE. Indeed the PAYE changes are likely to make the scheme more expensive because of the need to attract back to the British register ships which will have been forced off the Isle of Man register on to foreign registers by the changes.

#### Tax Relief on Foreign Earnings

8. The main advantage of a change to the rules on tax relief is that the change can be made quickly and easily and would meet the need for urgent action to stem the continuing decline of the fleet. It would go a considerable way towards compensating for the re-introduction of PAYE for Isle of Man vessels and would positively help deep-sea vessels on the UK register.

9. The change would reduce the cost of employing British seafarers and would help stem the fall in the number of British seafarers employed on ships. This is in itself an important objective for defence purposes as we have recognised in the assistance we are giving towards seafarer training and crew relief costs in the Merchant Shipping Act. By reducing the differential between British and Third World crew costs it will also reduce the cost of the contracts scheme if and when it is introduced.

10. The main disadvantage of the tax changes is that they are less precisely targeted on the need for specific types of ship. But they would be limited to the deep-sea sector which is where most of the ships in short supply operate. It would improve the position not just for product tankers but for container vessels and would therefore have a wider effect than the contracts scheme without unnecessarily benefiting the short-sea sector - particularly the ferries - where our wartime requirements are adequately served.





Conclusion

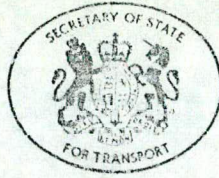
11. The two sets of proposals represent the most practicable options through public expenditure and through changes in the tax regime for seafarers (although we have not considered the alternative of changes to National Insurance Contributions in respect of seafarers). We have considered other forms of subsidy, including the proposal made at the last meeting for a subsidy to enable shipping companies to gross up seafarers' wages to offset their liability to tax. But other subsidies are less well targeted to our wartime needs and tend to have more deadweight.

12. I am satisfied that my proposals for a contracting scheme are the most cost effective type of subsidy to assist us in securing our wartime requirements. But without the tax changes there is a clear danger that there will be a further decline in shipping on the British register before the contracts scheme can be implemented, which will mean that the scheme will need to recover much more ground at greater expense. We agreed at the last meeting that action was urgently needed. The tax changes would have immediate effect and, by helping to reduce crew costs and to halt the drift away from the British register, they will make the contracts scheme cheaper to operate in the longer term.

13. I hope therefore that at our meeting we can decide:

- (a) to introduce an amendment to the current Finance Bill to extend the length of time which seafarers may spend in the United Kingdom while remaining exempt from UK tax to 90 days or one quarter of the qualifying period of at least 365 days; to come into effect at the same time as, or before, PAYE is re-introduced, and





(b) to press ahead urgently with the introduction of a scheme for contracting for vessels in short supply for wartime needs.

14. I am sending copies of this minute to Geoffrey Howe, Nigel Lawson, Douglas Hurd, George Younger, John Moore, David Young and Sir Robin Butler.

PC

PAUL CHANNON

3 June 1988



## CONTRACTING FOR MERCHANT SHIPPING

### WARTIME REQUIREMENTS

#### PAPER BY THE SECRETARY OF STATE FOR TRANSPORT

##### Introduction

1. The Prime Minister's meeting on Merchant Shipping on 4 May invited the Chancellor of the Exchequer and me to work up, in more detail, schemes for ensuring that the United Kingdom's wartime requirements could be met. This paper examines the option, discussed at our meeting, for a scheme of contractual arrangements with owners of vessels in short supply to secure their availability in time of emergency.

##### Current Requirements

2. The United Kingdom has a wartime requirement for merchant shipping for military support and for civil resupply. To meet the requirement we rely on powers to requisition vessels on the British register or vessels owned by United Kingdom interests and operated on foreign registers. Ships engaged in direct support of defence forces should be registered in the United Kingdom or Isle of Man and manned by crews acceptable in terms of security. For vessels engaged in civil resupply the place of registry and to some extent the crewing arrangements are less critical. But to avoid our having to rely on the market to provide sufficient vessels it is important that sufficient vessels should be subject to requisitioning. In practice there is a gradation of availability from UK registered ships which almost all have British crews, through ships registered on dependent territory registers, which may well have mixed crews, to ships on foreign registers with foreign crews working in foreign waters. This is illustrated in respect of product tankers in Table 1. To ensure



that the Government's requirements can be met it is important therefore that sufficient vessels of particular types are maintained on the United Kingdom and wider British registers.

### Objectives

3. The objective of the contract scheme would be to ensure that the Government had access to an adequate supply of particular types of vessel in order to meet defence and civil resupply requirements. This would be done by:

- (i) ensuring that British flag vessels already easily available remained so;
- (ii) providing an incentive for owners of vessels whose place of registry and crewing arrangements made them less easily available, to transfer to registers and crewing arrangements which made requisitioning easier;
- (iii) encouraging existing or new owners to make additional ships available.

### Coverage

4. The scheme could in theory be used for any particular class of ship but it is more appropriate for those types where there is a general and continuing demand in world markets. As explained in previous papers the category which demands immediate attention for defence requirements is that of product tankers. Product tankers are smaller tankers used for carrying refined petroleum products. They are essential in wartime for transporting fuel for defence forces and for supplying the United Kingdom's energy needs. On the latest projections there is a very fine balance between available supply and demand for military and civilian resupply. Demand for product tankers of 10-80,000 dwt has been critically re-examined to reflect latest thinking by the Department of Energy and is estimated at a minimum of 121 (28 for military and 93 for civil purposes).



5. There are at present only 122 British owned product tankers. This is a maximum figure which assumes that all suitable vessels on British registers (that is UK, Isle of Man and dependent territories) are requisitioned regardless of owner and vessels which are owned directly or indirectly by UK companies on other registers can be made available. But some are on registers and operate in areas which would make it difficult to effect a rapid recovery. In addition no allowance is made for loss of cargoes and ships due to enemy action although the figures do take account of reduced operating efficiency in wartime. Future supply may drop for a number of reasons. First there is the uncertain effect of changes in PAYE arrangements for seafarers employed by manning agencies on ships owned by UK companies and registered in the Isle of Man and elsewhere. Secondly, there is competition from other registries being set up to offer tax/social security concessions in eg. Norway and Denmark. This could lead to owners deciding to flag outside the UK and dependent territories and to employ foreign crews. To the extent that such movements are to other NATO flag countries they should not diminish the total number of tankers available in the NATO Pool for civil resupply (see para 15). But such movements will deplete the numbers of British crews and vessels under our control and this will ultimately have an effect on the core fleet available for military purposes. For these reasons a prudent target for the scheme might be assured availability of 150 tankers.

#### Outline of Scheme

6. Shipowners would be invited to contract to maintain product tankers (or any other type of vessel) under conditions which guarantee ready availability and appropriate crewing in the event of an emergency.

7. We need further study in consultation with the industry to work out the most economic and reliable set of contract conditions. But it seems clear that the contract would need to control:



- (i) The number, type and size of ships
- (ii) The flag of registry
- (iii) The nationality/certification of the crew
- (iv) The availability of the vessel
- (v) The duration of the obligation.

It would be possible to vary the type of contract according to need. If the UK and Isle of Man registers were to decline substantially we might need to contract for tankers needed for direct support of defence forces, in which case we would envisage stringent conditions specifying a United Kingdom or Isle of Man registry and at least all UK officers. We might also need to specify availability in geographical terms eg. at a UK Port within fifteen days.

8. The immediate requirement is, however, for tankers to be used for civil resupply. For these it should be enough to specify:

- United Kingdom, Crown Dependency or Dependent Territory registration
- UK senior officers
- Availability after completion of current voyage.

#### Cost

9. A key feature to keep down public expenditure would be competitive tender. Owners would be invited to submit bids for the compensation payment which they would require to operate ships under the conditions specified in the contract. The use of competitive tendering should ensure that the level of subsidy is set at the minimum necessary to achieve the objectives of the scheme. But there will inevitably be some deadweight in the scheme as it would have to cover tankers operating commercially which already meet the requirements of the contract and are available without subsidy. Any attempt to exclude ships already available could be circumvented by owners taking their ships off the register temporarily and then flagging in to benefit from the scheme. There are, however, still strong commercial pressures encouraging owners to flag out and without action we would expect the drift from the UK flag to continue. The availability of the



scheme should therefore encourage owners to stay on the British register who would not otherwise do so and to that extent the subsidy would not be wasted. Moreover, competitive tendering should help minimise the deadweight as shipowners already meeting the requirements of the contract commercially could be expected to submit lower bids.

10. The total cost of the scheme will depend on the conditions attached to the contract, in particular the degree of difference between the cost of crews operated on a commercial basis and those required under the contract. For those companies already operating commercially in line with the requirements of the contract a somewhat smaller amount than the actual difference in costs would be required. For product tanker of 40,000 dwt currently operating on a foreign register with a third world crew the additional crew cost of transferring to a dependent territory register and operating with UK senior officers is estimated as £50,000 per annum. Transferring to the Isle of Man register and employing a full UK crew on an offshore agreement would raise this figure to £200,000 per annum. We think most operators would find it unsatisfactory to re-crew with UK senior officers without at least employing British (or Commonwealth) junior officers, though they could be more flexible as regards the nationality of ratings. An average re-crewing cost would therefore be around £100,000 per vessel per annum. In addition we would expect to have to pay an annual premium to cover the initial cost of transfer to the British register and to compensate owners for the loss of flexibility. This might add about 30% to the simple crew costs. For a requirement of 150 vessels on a less restrictive contract the total cost would therefore be of the order of £20m per annum (150 vessels at £100,000 crew costs + £30,000 premium = £19.5m + some administrative costs falling on my Department.)

11. Although the scheme has been outlined and costed on the basis of its application to product tankers it could be used for other classes of vessel, as necessary, to take account of any shortfalls in the supply of types of ships relative to our defence requirements.



## Legislation

12. The scheme would require primary legislation.

## Assessment

13. The advantage of the scheme as outlined is that it provides a method of targetting subsidy most accurately at the specific categories of shipping where our needs are most urgent.

14. The scheme is intended to have a twofold effect on the supply of vessels in an emergency - to make those already available more readily available and to attract additional tonnage into the pool of available vessels. There are a number of tanker owners, both oil majors and independents on the UK register eg. Cunard, Canadian Pacific, Furness Withy, Maersk, Swire, Silver Line, BP, Shell etc., who might find it attractive to expand again under the terms of a subsidy contract. However, the degree to which the oil majors would be willing to transfer ships from other registers/direct ownerships may be constrained by the operational requirement to have them flagged and/or owned in certain countries. There are also other possible sources of ships which already have links with the UK -eg. ships managed or owned by Hong Kong interests (eg. World-wide Shipping) or Greek shipowners based in London - who may also be attracted by the scheme.

15. The effectiveness of the scheme might therefore be assessed by the extent to which it encouraged the switch of existing UK owned vessels from less to more desirable registry and manning arrangements as well as the extent to which it increased the total pool of product tankers available.

16. The effect of the scheme on the number of vessels available for civil resupply, for which NATO resources are pooled, needs to be considered in a NATO context. The scheme will increase the number of vessels available to NATO to the extent that it adds to the pool of vessels firmly available to all NATO countries. Table 2 summarises the present supply position of tankers which could carry products. On the assumption that pooling arrangements operate as planned there would be no value, in NATO terms, in



movements within the NATO pool. Such movements would, however, be of value to the UK as they would add to the number of vessels which would be under our direct control and would minimise the extent to which we needed to rely on the, possibly uncertain, operation of the NATO pool. In addition, if other NATO governments follow our example and contract with their owners on a similar basis, the pool will be further enhanced.

17. The effectiveness and cost of the scheme will also depend on the general attractiveness to shipowners of operating on the British register and particularly the ease of employing British crews. Measures we have taken in the new Merchant Shipping Act to assist with training and crew relief costs are designed to make it easier to employ British crews. But it will take some time for these to take effect and, in the meantime, shortages of British junior officers might make it difficult for owners to take advantage of the scheme even if they wanted to. And decisions on the personal taxation of seafarers will also clearly influence the likely attractiveness of the scheme.

#### Political Reactions

18. I would expect the scheme to be widely welcomed in Parliament and outside. There would be pressure for early legislation to give it effect. We would clearly have to resist Opposition pressure to use the scheme to secure protected employment for British ratings on NUS terms.

19. We would need to handle the scheme carefully in international organisations. The European Commission have been under pressure to come forward with ideas for 'positive measures' to help Community fleets, and there will, rightly, be concern that a proliferation of different schemes of assistance in Member States could be counter-productive. In general terms, any form of assistance to the shipping industry will weaken our position in arguing against protectionism. But a scheme that was very clearly tied to our strategic requirements would be less damaging to that cause and should be proof against any action under the state aids provisions of the Treaty of Rome.



## Conclusion

20. The next step would be to work up the necessary legislation, the terms of the contract, and a programme for assessing the effectiveness of the scheme with a view to having the scheme in place to use, as necessary, to secure the supply of particular types of vessel.



TABLE 1

Distribution by Register of Vessels available to the UK to carry Products

UK Mainland	31	
IOM	36	
Sub Total		67
Bermuda	11	
Cayman	3	
Gibraltar	3	
Hong Kong	18	
Sub Total		35
Other Registers		20
Grand Total		122

Notes 1. Figures include Royal Fleet Auxiliaries.

2. Figures exclude Shell vessels in Argentina and Australia - assumed not to be available for UK purposes. Other registers made up of 14 Liberia, 3 Bahamas, 2 Panama, 1 Malta.

3. Figures for UK mainland, IOM and dependent territories include all vessels in those registers which meet the size and type specification regardless of ownership.



Distribution of Vessels Which Can Carry Products by  
Owner and Register (numbers)

<u>Register</u>	<u>British or National</u>	<u>Open Registers</u>		<u>Total</u>
		<u>Liberia &amp; Panama</u>	<u>Other(1)</u>	
<u>Allegiance of owner</u>				
<u>UK(2)</u>	102	14	6	122
<u>Other NATO</u>				
Belgium	4		5	9
Canada	11			11
Denmark	24		5	29
France	10			10
Greece	86	32	45	163
Italy	72			72
Netherlands	7	7		14
Norway	20	19	6	45
Portugal	5			5
Spain	16			16
Turkey	14			14
US	133	58	13	204
West Germany	6	2		8
	408	118	74	600
<u>Uncommitted</u>				
Algeria	5			5
Argentina	24			24
Australia	8			8
Brazil	34			34
Ecuador	7			7
Hong Kong		34		34
India	37			37
Indonesia	19	35		54
Iran	12			12
Iraq	7			7
Japan	32	61		93
Korea	7			7
Kuwait	3	6		9
Mexico	28			28
Peru	7			7
Saudi Arabia	11			11
Singapore	12			12
UAE	12			12
Venezuela	17			17
	282	136		418
<u>Neutrals</u>	22			22
<u>Communist Bloc</u>	279			279



Table 2

Distribution of Vessels Which Can Carry Products by  
Owner and Register

Notes

- (1) Includes Bahamas, Cyprus, Malta and Singapore.
- (2) All vessels on British registers are taken to have allegiance to the UK regardless of actual nationality of owner.

Explanatory Note

The top line of Table 2 shows the available tankers to the UK as recorded in Table 1. The section below shows the number of tankers owned in NATO countries. The first column shows the number registered in the country of ownership while the second column shows the number registered elsewhere. Most of these vessels are probably available to NATO in times of crisis though there may be some problems with suitable crews of vessels currently on open registers. The next section of the table shows tankers owned and registered in non NATO countries. There is a wide variety of ownership here both by nationality and type of owner (oil company, private or state ownership). One of the targets of the contract scheme would be the group of uncommitted owners who did not need to be on particular registers or have particular nationality of crews for trading purposes.





*RF*

MR WHITE

FROM: J J HEYWOOD  
DATE: 6 June 1988

*ch/ see also minute  
from Mark Call behind*

cc PS/Chancellor  
PS/Chief Secretary  
PS/Paymaster General  
PS/Economic Secretary  
Sir P Middleton  
Mr Anson  
Mr Phillips  
Mr Monck  
Miss Peirson  
Mr Burgner  
Mr Waller  
Mr Sharratt  
Mr Call

*✓ mpw 7/6*

**JAMES MACKIE & SONS**

The Financial Secretary has seen your minute of 3 June and Miss Wallace's of 6 June.

2. The Financial Secretary agrees that you should **press NIO officials hard on the adequacy with which Lazards have explored the dowry possibility and that you should stress the need to identify a suitable management team** before Mr King approaches colleagues again.

3. The Financial Secretary believes that if or when Mr King returns to colleagues with his earlier proposal, he should make clear not only the ways in which it falls short of the remit given by E(A), as the Chancellor has suggested, **but also why the alternative dowry proposal was not on.**

*J.H.*

**JEREMY HEYWOOD**  
Private Secretary





*[Handwritten signature]*

FROM: MISS M P WALLACE  
DATE: 6 June 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
- Mr Waller
- Mr A M White
- Mr Sharratt
- Mr Call

**JAMES MACKIE & SONS**

The Chancellor has seen Mr White's minute of 3 June. He has commented that if and when Mr King returns to colleagues with his earlier proposal, he should make clear the ways in which it falls short of the remit given by E(A).

*[Handwritten signature]*

MOIRA WALLACE



ppp p1  
FROM: MARK CALL  
DATE: 6 JUNE 1988

FINANCIAL SECRETARY

cc Chancellor<sup>e</sup>  
Chief Secretary  
Paymaster General  
Economic Secretary  
Sir Peter Middleton  
Mr Anson  
Mr Phillips  
Mr Monck  
Miss Peirson  
Mr Burgner  
Mr A M White  
Mr Waller  
Mr Sharratt

JAMES MACKIE & SONS

The options on the table regarding Mackie's are all rather unsatisfactory, and it may be helpful to reconsider what is the problem we are trying to solve. I am certain that the reason the proposals sound so unconvincing is that the underlying business is of doubtful viability. Mr King is, I'm sure, driven more by the political need to 'do something' for West Belfast, than by a desire to save Mackie's per se. If so, should we encourage him to think about the unthinkable, and instead of taking action to bail out Mackie's, put resources into activities which are likely to have a long term benefit? So instead of putting Mackie's on a life support system, why not invest in infrastructure, training or enhanced grants to attract inward investment? As well as being better economics, that may be better politics.

2. If this is judged to be out with the realm of the possible, then the dowry approach (as opposed to loans which would never be repaid) has much to commend it. This would reduce (rather than prevent) the risk of the action being described as a nationalisation going against the grain of Government policy. But whatever we may put into such a contract, there can be no guarantee that the company taking over Mackie's wouldn't come knocking on the door of the future seeking a further 'maintenance payment'.

Mc  
MARK CALL



CONFIDENTIAL

FROM: A R WILLIAMS

DATE: 7 June 1988

1. MR REVOLTA
2. CHANCELLOR

cc Financial Secretary  
Chief Secretary  
Sir P Middleton  
Mr Anson  
Mr Philips  
Mrs Case  
Miss Hay  
Miss Barber  
Mr Ramsden  
Mr Tyrie  
Mr Isaac IR  
Mr Lewis IR  
Mr Fraser IR  
PS/IR

#### MERCHANT SHIPPING AND DEFENCE

1. A further meeting on merchant shipping and defence has been called by the Prime Minister for 8 June. At the last meeting, on 4 May, it was agreed that action must be taken to ensure that the UK could meet its wartime shipping requirements. This could take one of two forms: new tax reliefs for seafarers or subsidies. A final choice was deferred until the options had been worked up in more detail.

2. You have circulated a paper which discusses two possible tax relief options. It firmly rejects one, to exempt from tax crews of UK, Crown Dependency and Dependent Territory registered ships, but accepts that the other, to relax the rules governing seafarers eligibility for 100% foreign earnings deductions, would provide a workable scheme. However it argues strongly that subsidies are preferable to tax reliefs.

3. Mr Channon has circulated a paper which presents only one option, a scheme for contracting for ships in short supply. In his covering note he argues in favour of both this option and the relaxation of the foreign earnings deduction rules, mainly because the contract scheme could not be introduced immediately (as it requires legislation).

#### Line to take

4. You will wish to argue that:



- Tax reliefs for seafarers should be rejected, as they conflict with the Government's tax policy and are likely to be ineffective in securing wartime shipping needs. Since it has been agreed that something must be done, it follows that this should be Mr Channon's contract scheme. A speaking note is attached.
- If colleagues nevertheless decide a tax relief is essential, it should be the relaxation of the foreign earnings deduction rules. Tax exemption for crews of UK Crown Dependency and Dependent Territory registered ships should be firmly rejected.
- The contract scheme needs to be further examined. In particular it should not result in ships merely being poached from other NATO countries.
- Ideally no announcement of the contract scheme should be made until further work has been done on how it would operate and how much it would cost. However this might not be realistic, given the need to tell shipping companies soon about their liability to operate PAYE as soon as possible and colleagues' wish that this should be accompanied by an announcement of assistance for merchant shipping. At the least, any announcement should avoid open-ended expenditure commitments, and should be cleared with the Treasury.
- The cost of the subsidy scheme should be met from within existing DTp provision and Treasury officials should be consulted about the details of the scheme as they are worked up.

#### Background: Subsidy versus Tax Relief

5. In order to secure the UK's wartime merchant shipping needs we need to ensure both that there are sufficient ships of the right type available for our use and that there are British crews (or at least officers, non-British ratings would be acceptable in ships used for civil resupply) available to man them. In principle, Mr Channon's contract scheme would achieve both aims as it would be a condition of contract that ships of the specified type should be available and that they should be manned by British crews/officers as appropriate.



6. A tax relief might have something of the same effect, to the extent that by making British seafarers potentially cheaper to employ, it encouraged owners to remain on/return to the UK or Isle of Man registers. But it would be a very hit and miss affair. As the tax relief would go to individual seafarers, there would be no assurance that it would reduce crewing costs for companies (a point the GCBS have themselves made). Insofar as it did, it might not be enough to induce them to adjust their flagging policies (conversely it could be more than was required), and there would be no commitment by owners to make ships available. Moreover the more attractive tax relief (the relaxation of the foreign earnings deduction rules) could not be targetted on types of ships required for defence purposes. In short it would be a policy of throwing money at the industry in the hope that it might induce some helpful changes; but there would be no guarantee of any return.

7. There are however, from Mr Channon's point of view, two major advantages to a tax relief. First, it could be introduced immediately, by an amendment to the Finance Bill, whereas his contract scheme would have to find a place in the legislative programme. But the contrast is not so stark as it seems since the contract scheme will start to make an impact as soon as it is announced, and a good deal of work on it with the shipping industry should be possible before the legislation is finalised. The second major attraction to Mr Channon is of course that the cost of the tax relief would be borne on tax revenue rather than the DTp vote. So although from the Government's view point a contract scheme alone is more likely to be more cost effective than a tax relief plus a somewhat cheaper contract scheme, DTp are bound to see advantages in a - to them - costless tax relief.

8. Mr Channon argues that without a tax relief there will be a further decline in UK registered shipping (exacerbated by the PAYE decision), and that the contract scheme when eventually implemented would have more ground to make up and would hence be more expensive. Against this it may be argued:

- (i) It does not make much sense to take action which is likely to be ineffective merely because it can be taken quickly.



(ii) The supply of merchant shipping for the UK's wartime needs does not justify panic measures. Even for the category of vessel identified by DTp as most at risk, product tankers of 10-80,000 dwt, 122 vessels are available as against a need for 121, and this does not include foreign owned and registered vessels which might be obtainable from the market. Moreover the number of these vessels on the UK and IOM registers increased from 64 at the end of 1986 to 73 in March 1988. Admittedly this was largely because of the decision of one company (Maersk) to transfer from the Danish to the IOM register, but it illustrates that the supply and demand position is complex and by no means a simple downward trend.

(iii) NATO considerations suggest caution on early action. Norway and Denmark have set up special registers offering tax/social security concessions. Tax reliefs offered by the UK could provoke similar action by other European competitors. A proliferation of competing schemes of assistance by NATO member states would be wholly counter-productive, given that NATO would pool its merchant shipping in wartime. (This objection also applies to the contract scheme but as it would take longer to implement, we would have a better idea of the overall NATO position before any expenditure was committed).

(iv) Even if it did turn out that ships left the UK or IOM registers as a result of the PAYE decision, it would be better to have a more expensive but accurately targetted contract scheme when the extent of the loss was clear rather than to commit ourselves in advance to a tax relief of uncertain effect in the vague hope that this would reduce the loss.

9. At the 4 May meeting, the option of a subsidy which would enable shipping companies to gross up seafarers' pay to offset their tax liability was mentioned. Mr Channon rejects this briefly as being less well targetted than his contract scheme and with greater deadweight. These objections are valid, and although such a subsidy would in some ways be better than a tax relief (because the money would go to shipping companies not to individual seafarers in the first instance), it would require specific legislation and hence would not meet Mr Channon's problem about timing.



## Details of the contract scheme

10. Given that the decision has been made to do something for shipping, Mr Channon's contract option is the best one going, as it is clearly targeted on specific defence needs. It is, however, not without difficulties, though some of these might be soluble with further work.

11. Mr Channon's paper does not give much detail about how the scheme would operate in practice, but we understand from DTp officials they have in mind letting a number of contracts each for a specified number of product tankers, such that all the contracts together would meet the estimated defence needs for this category of vessel. Each contract would be put out to competitive tender and they would probably be let sequentially so that the Department could if necessary adjust the later ones on the basis of experience gained with their predecessors.

12. With the early contracts, companies would be bidding to keep on the UK or IOM registers ships that were already there. Bids should therefore be relatively low and though the cost would be largely deadweight, the contracts would at least ensure that the vessels concerned were not flagged out at some future time.

13. The later contracts, which would require vessels to be brought on to the UK, Crown Dependency or Dependent Territory registers, would be more expensive. We have no means of knowing now whether the subsidy which might be required for these later contracts would be unacceptably high. If shipowners had to purchase new ships, it might be so (indeed they might not even be willing to bid). But there are, apparently, foreign owned and registered product tankers whose owners might well be prepared to reflag to a British registry, and the subsidy they would require might not be excessive. Thus the cost effectiveness of the scheme would not be clear until tendering begins. It is important that the Government should not commit itself to proceeding whatever the size of the bids.

14. There is a risk, as Mr Channon's paper recognises, that ships attracted onto the British registers by this scheme would come from the registers of other NATO countries. This would do nothing for NATO's collective defence needs and could provoke an expensive competitive auction among NATO members. It should perhaps be a requirement that ships attracted onto the British registers by the subsidy should not come from other NATO registers, though this needs further consideration by officials. The EC dimension also needs to be explored.

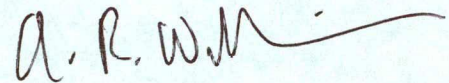


15. The subsidy paid under the contract scheme would probably be taxable if the recipient shipping company was itself taxed in the UK, though a final judgement on this point will depend on the precise arrangements of the scheme.

#### Business Expansion Scheme

16. In your paper you propose to increase from £500,000 to £5m the limit on the amount of BES finance which can be raised in one year by a company which operates its own ships. The £5m limit already applies to companies letting ships on charter. It seems unlikely that this concession will make a great contribution to meeting defence needs, if only because chartering is, we understand, the normal way of operating larger ships. However colleagues may well feel that the concession is a helpful gesture.

17. This brief has been agreed with the Inland Revenue.



A R WILLIAMS



## SPEAKING NOTE

- We agreed at last meeting to choose between a subsidy scheme or a tax relief.
- Tax reliefs likely to be much less effective than subsidies:
  - do not necessarily feed through into lower costs for shipping companies (a point which concerns GCBS)
  - even if they do, have no assurance that amount will be sufficient to persuade shipping companies to continue with/return to British flag
  - does not commit companies to retaining British flag in future
  - much less easy to target on types of vessels required for defence purposes.
- Tax reliefs also conflict with our general taxation policy of sweeping away special reliefs and tax shelters, and would be repercussive. Tax exemption for crews on ships on IOM or other British registers (Annex A of paper) particularly objectionable in this respect. Unfair and likely to build up pressure for similar exemptions in other hard pressed industries.
- Paul Channon argues that tax relief needed because subsidy scheme cannot be introduced immediately. But:
  - . No point in taking ineffective action merely because it can be done quickly
  - . Supply of ships for defence purposes does not justify hasty, second-best measure. Supply of product tankers (worst case) in balance with requirements, and trend is not easy to read.
  - . Must not rush into action which might provoke a counter-productive auction among NATO members: would not help defence needs
  - . Better to have a more expensive but well targetted contract scheme later than an unsatisfactory tax relief now.



- Can use BES concession as partial offset to adverse impact of PAYE decision.

- Thus urge rejection of personal tax reliefs. But if colleagues do not agree, least harmful tax option is relaxation of rules for foreign earnings deduction.



" It is very annoying that Mr Clarke + Mr Rifkind will not come to the party on this issue. Despite the small sums involved there is an important point of principle at stake which argues for you to continue to

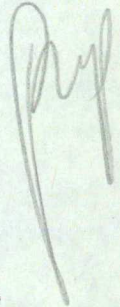
From: Michael Romberg

8 June 1988

File: IRARD G/23

cc Mr Burgner (cc)  
Mr Moore  
Miss Peirson  
Mr Turnbull  
Mr AM White  
Ms Mary Brown  
Mr Guy  
Mr MG Richardson  
Dr Baker  
Mr Call  
Mr RH Potter  
Mr Wood  
Mr N Williams (o/r)

take a firm line!



SECRET

*It is very annoying that Mr Clarke and Mr Rifkind will not come to the party on this issue. Despite the small sums involved there is an important point of principle at stake which argues for you to continue to take a firm line.*  
MWR  
8/6

1. Mr Waller

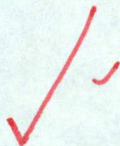
2. Chief Secretary

Copies attached for:

Chancellor

Mr Anson

Mr Monck



**BRITISH SHIPBUILDERS: FINANCING REMEDIAL MEASURES**

1. On 17 May 1988 you wrote to Mr Clarke asking that he and Mr Rifkind bear the cost of shipbuilding remedial measures in 1988-89. Mr Clarke's reply of 31 May 1988 offers some relief and Mr Rifkind's of 2 June 1988 none. This submission advises you to stand firm so as not to prejudice your position in the Survey. A draft reply is attached.

2. The costs of shipbuilding remedial measures in 1988-89 are expected to be approximately:

England	
Advance factories:	£2m - £3m
Enterprise company:	£2.65m
Total England	£4.65m - £5.65m
Scotland	
Enterprise Company:	£1.1m
Total GB	£5.75m - £6.75m

3. Your letter of 17 May 1988 left it to departments to pay for all the remedial measures in 1988-89. Mr Clarke had already undertaken to pay for the factory building. His reply of 31 May 1988 agrees to finance also some of the enterprise company in England up to total expenditure of £4m provided that:

- (i) Mr Rifkind finds the money for Scotland; and
- (ii) the Reserve bears the risk of an overspend.



SECRET

4. Mr Rifkind's letter of 2 June 1988 declines to find any money and suggests deferring consideration until the position is clearer.

5. The sums in dispute are small - a risk of up to £1.65m in England; expenditure of £1.1m in Scotland. You need not be concerned with whether it is DTI or the Scots who find the money. But to agree to the Reserve bearing the risk of an overspend would run contrary to the whole ethos of cash limits. And having the Reserve fund any of these costs in 1988-89 would prejudice your position in the Survey on the costs of remedial measures in later years - about £25m. I therefore **recommend** you stand firm and insist that DTI and the Scots agree to finance these small sums out of their own resources. A draft is attached for your use.

6. This submission has been cleared with GEP2 and PE2.

MR

Michael Romberg  
IAE2  
270 4662  
Rm 114/G

SECRET



SECRET

DRAFT OF 8 JUNE 1988

The Right Honourable  
Kenneth Clarke QC MP  
Chancellor of the Duchy of Lancaster  
and Minister of Trade and Industry  
Department of Trade and Industry  
1 - 19 Victoria Street  
London  
SW1H 0ET

BRITISH SHIPBUILDERS: FINANCING REMEDIAL MEASURES

1. Thank you for your letter of 31 May 1988. I have also seen Malcolm Rifkind's of 2 June 1988.
2. I agree that it is desirable that there should be a ceiling on expenditure on remedial measures in 1988-89. If £4m now looks to be the likely level of spend then I would have no objection to this limit being imposed on expenditure in England. But I really cannot agree that the Reserve should carry the risk of any overspend; this would be quite contrary to well established cash management disciplines. As you are only too well aware, the Reserve is under pressure this year and I must therefore continue to look to you to finance any excess you might choose to allow over the £4m in 1988-89.
3. As for the Scottish enterprise measures, it is unsatisfactory that Malcolm and you should not yet have been able to reach agreement on financing. I should be willing to go along with any reasonable agreement that was made on financing these small expenditures in 1988-89 from existing DTI and Scottish Office provision. I therefore welcome the opportunity of looking at the proposals you may make either as Malcolm suggests once the expenditure implications are clearer or sooner if you prefer.
4. Copies of this letter go to the Prime Minister, David Young, Malcolm Rifkind, Tom King and Nicholas Ridley, and to Sir Robin Butler.

JOHN MAJOR

SECRET



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

0000007

Rt Hon John Major MP  
Chief Secretary  
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

CHIEF SECRETARY	
REC.	- 1 JUN 1988
<i>Mrs Brown</i>	
<i>Cx Mr Anson Mr Morch</i>	
<i>Mr Bugner Mr Moore</i>	
<i>Mrs Pearson Mr Turnbull</i>	
<i>Mr AM White Mr Waller</i>	
<i>Mr Richardson Mr Call.</i>	
<i>Mr Patter Mr SN Wood.</i>	

*Mr King*  
*Admin. p.*  
*MW*  
*1/16*

Direct line 215 5147  
Our ref  
Your ref  
Date 31 May 1988

*Dear John,*

**BRITISH SHIPBUILDERS: FINANCING REMEDIAL MEASURES**

Thank you for your letter of 17 May.

I am sorry you are not able to proceed on the basis I had thought we had agreed for 1988-89. In view of the reduced level of expenditure now expected for that year - and the figures may be even lower than those mentioned in your minute - I can reluctantly agree to contribute to some enterprise measures in addition to advance factory provision, so long as Malcolm Rifkind is prepared to do the same for measures for Scotland. However it is essential that I should have a cash ceiling for my Department's contribution, and that any excess should be met from the Reserve. In view of the prospects of reducing the scale of expenditure in 1988-89 from that previously forecast, I propose that the ceiling on my Department's contribution should be set at £4 million.

*1. Additional + contingency?*

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

1988-89  
Fact Bldg 2-3  
Ent 6 Eng 2.65  
Sect 1.1  
-----  
4.65-5.65 1.1

*J*  
*cur,*  
*L.*

*(S) Sub. Pelling. Sect  
Sect of OT  
(C) War f. R/b. 1*

KENNETH CLARKE

MY4ABL





SECRET

SCOTTISH OFFICE  
WHITEHALL, LONDON SW1A 2AU

The Rt Hon John Major  
Chief Secretary to the Treasury  
Treasury Chambers  
Parliament Street  
LONDON  
SW1P 3AG

SECRETARY		0000012
REC.	- 3 JUN 1988	
ACTION	Mrs Brown	
COPIES TO	CX Mr Anson Mr Monck Mr Bugner Mr Moore Miss Benson Mr Turnbull Mr BM White Mr Diller	
	Mr Richardson Mr Potter	

*W. Hooper*  
*Blue speak.*

*pub*  
*2 June 1988*

*Dear John*

*MRSN Wood McCall*

Thank you for the copy of your letter of 17 May to Kenneth Clarke. I have also seen Kenneth's letter to you of 31 May.

My position on the funding of the remedial measures is unchanged from my letter of 9 May. I am quite prepared to support Kenneth's proposal for an enterprise company to deal with job losses at British Shipbuilders, and it would be indefensible for the company not to operate on a Great Britain basis. But as it is to be a subsidiary of British Shipbuilders, it has absolutely nothing to do with my responsibilities, and I see no reason why I should be involved in its funding. The establishment of an enterprise company is inseparable from the break-up of British Shipbuilders, and I cannot see the point of trying to distinguish the costs of the company from the other costs which might be incurred.

I suggest that, with so many uncertainties about the future of the individual subsidiaries, the impossibility at this time of predicting where, when and how many redundancies might take place and only the most approximate of cost estimates, further consideration of this issue might best be deferred until we can approach it in a more informed way, and when Kenneth can present a fully worked-up proposal for the enterprise company, if indeed it is still needed.

Copies of this letter go to the Prime Minister, David Young, Tom King, Nicholas Ridley and Kenneth Clarke, and to Sir Robin Butler.

*Yours ever,*  
*Malcolm Rifkind*

MALCOLM RIFKIND



SECRET



C  
 PS/Chancellor  
 Mr Anson  
 Mr Monck  
 Mrs Burgner  
 Mr Moore  
 Miss Peirson  
 Mr Turnbull  
 Mr A M White  
 Mrs M Brown  
 Mr Waller  
 Mr Richardson  
 Mr B H Potter  
 Mr S Wood  
 Mr Romberg P/A C/23  
 Mr Call

Treasury Chambers, Parliament Street

The Rt Hon Kenneth Clarke QC MP  
 Chancellor of the Duchy of Lancaster  
 Department of Trade and Industry  
 1 - 19 Victoria Street  
 London  
 SW1

17<sup>th</sup> May 1988

**BRITISH SHIPBUILDERS: FINANCING REMEDIAL MEASURES**

Thank you for your letter of 6 May 1988. I am also replying to Malcolm Rifkind's letter of 9 May and to Nicholas Ridley's of 20 April.

I am pleased that you have felt able to accept my suggestion that the cost of remedial measures in future years should be decided in the Survey. That should enable us to take a well informed view of priorities.

As for 1988-89, I note from your letter that you feel we had agreed to split the 1988-89 costs of remedial measures, with your programme bearing the costs of advanced factory provision and the Reserve meeting the cost of the enterprise package. Clearly there has been some misunderstanding between us. My approach to this issue assumed that the great bulk of the £7½ million advanced factory provision endorsed by colleagues would fall in the current year and that you were offering to meet these sums from your existing provision, leaving only the financing of the 1988-89 costs of the enterprise package to be discussed between us.

As your letter makes clear, the 1988-89 costs of remedial measures are now much smaller than originally agreed with advanced factory provision of only some £2 million and an enterprise package costing £3.75 million (including provision for measures for Scotland and Bideford which have not been discussed or formally agreed). This compares with a potential claim on the Reserve of perhaps

87/88

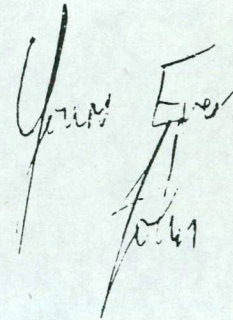


SECRET

£100 million, to which I agreed in my letter of 4 May, associated with the disposal of Govan and closure or disposal of other BS facilities. I would not necessarily wish to challenge the need for additional enterprise measures covering not only Sunderland but also Scotland and Bideford. But given the major claim on the Reserve I have already conceded and the modest overall size of the spend on remedial measures this year, I consider it entirely reasonable that these costs should be found from within existing programmes. I must therefore continue to look to you and to Malcolm Rifkind to finance the costs of the enterprise package in 1988-89.

On other remedial measures, I am grateful for Malcolm's assurances that any non enterprise company costs will be met from within his existing provision. And Nicholas Ridley has helpfully agreed that the costs of the Sunderland enterprise zone are to be met from within his programme. I am grateful for this and would only wish to note that the scale of the enterprise zone would need to proportionate to the scale of redundancies. Any substantial continuing activity at NESL should lead to a lower call on his programmes. Similarly, the current advance factory provision for Sunderland envisages complete or near complete closure of NESL. We might need to revisit this issue again in the (seemingly unlikely) event of substantial continuing shipbuilding activity at NESL.

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

A handwritten signature in dark ink, appearing to read 'John Major', with a stylized flourish at the end.

JOHN MAJOR



CONFIDENTIAL



10 DOWNING STREET  
LONDON SW1A 2AA

*1 hope we can  
do X, & look forward  
to my ASAR.*

*Pinel  
on.*

From the Private Secretary

CH/EXCHEQUER	
REC.	09 JUN 1988
ACTION	Mr A.R. Williams
COPIES TO	PS/FST; Sir P. Mellor,
	Mr Anson, Mrs Case
	Mr Lewis - IR
SHIPPING	

✓ 1/6 8 June 1988

Dear Roy,

The Prime Minister yesterday held a further meeting to discuss merchant shipping. I should be grateful if you and copy recipients would ensure that this record of the discussion is shown only to those with an operational need to see it.

Those present at the meeting were the Chancellor of the Exchequer, the Secretaries of State for Defence, Trade and Industry and Transport, the Minister of State at the Foreign and Commonwealth Office (Mrs Chalker), the Parliamentary Under Secretary of State, Department of Health and Social Security (Mr Portillo), Mr Wilson and Mr Monger (Cabinet Office) and Mr Bourne (No 10 Policy Unit). The meeting considered minutes dated 3 June by the Chancellor and the Secretary of State for Transport.

The Secretary of State for Transport said that the group had earlier agreed that action should be taken to ensure that the United Kingdom's wartime shipping requirements could be met. In his minute he had, as requested, developed a proposal for a scheme for contracting with shipowners to keep their vessels available for wartime use when needed. If applied to product tankers, where at present the need seemed greatest, it would ensure that 150 would be available for a cost of about £20 million a year. It could also be applied to other classes of vessel as necessary. Such a scheme was well targeted and seemed the most cost-effective solution to the problem. But by itself it would not be enough, since it would need primary legislation and so take until 1990 or later to implement, whereas once the changes in PAYE were known there could be an early exodus of ships on to foreign registers. He therefore believed that there should also be an early tax change, to offset the PAYE change. Of the options described in the Chancellor's paper, he favoured the second: the relaxation in the rules governing seafarers' eligibility for the 100 per cent foreign earnings deduction.

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In discussion, the following were the main points made:

- (a) There were strong objections to a subsidy scheme. It would involve extra public expenditure and lead to pressure for further subsidies elsewhere. There was a risk that it would simply encourage shipowners to raise wages at public expense. And we could not be quite sure that it would be proof against challenge by the European Commission as a defence measure.
- (b) It would also be wise to avoid any commitment to a subsidy scheme until the NATO studies on requirements and availability were complete. Some indications of the outcome of these studies should be available in three or four months' time.
- (c) The relaxation for seamen of the rules for the foreign earnings deduction also ran some risk of being repercussive, although the Government could resist pressure to extend the concession to others by pointing to the defence case for it for seafarers. It would arguably be less well targeted than the subsidy scheme, although it was also true that any increase in the number of British seafarers was in our long term strategic interest. Finally the tax concession would have the major advantage that it could be effected very quickly by an amendment to the Finance Bill now going through Parliament.
- (d) One way of improving the targeting of the extension of the foreign earnings deduction would be to apply it only to those seafarers who were prepared to join a reserve which would be available for service in wartime. Such a condition would also make it easier to resist pressure for a similar concession to other groups.

The Prime Minister, summing up the meeting, said that, subject to satisfactory ring-fencing, the group agreed on the relaxation for seafarers of the rules governing their eligibility for the 100 per cent foreign earnings deduction which had been described in the Chancellor's minute. The necessary amendment should be introduced during the Committee Stage of the Finance Bill so that the change would have effect for this year. As to ring-fencing, the group were attracted to the possibility that eligibility for the extension of the relief should be conditional upon joining a reserve available for service in wartime. This possibility should be considered further by the Chancellor of the Exchequer, in consultation with the Secretaries of State for Defence and Transport. If it was found practical to impose such a condition, the Finance Bill amendment should provide for it.

The Group saw serious disadvantages in a subsidy scheme, and believed that it would be wrong to have both a subsidy and a tax concession. They had therefore decided against the introduction of such a scheme at present. If, when the NATO studies were complete, there appeared to be a possible need



CONFIDENTIAL

- 3 -

for such a scheme, there might be a case for working it up in detail as a contingency. But no public indication should be given that such a scheme was under consideration.

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

Yours,  
Paul

PAUL GRAY

Roy Griffins, Esq.  
Department of Transport

CONFIDENTIAL



CONFIDENTIAL

1. (Discussed in draft with Mrs Brown)
2. CHIEF SECRETARY

FROM: W GUY  
DATE: 9 June 1988

cc Chancellor  
Financial Secretary  
Sir P Middleton  
Mr Anson  
Mr Monck  
Mr Moore  
Mr Burgner  
Mrs Brown  
Mr A M White  
Mr Waller  
Mr Rutnam  
Mr Call  
Mr Tyrie

*Don't like this  
@ all (dowry + IF suppl.)  
Don't CST  
dtd.*

*Ch.  
Agree with general line (para 8)  
if Mr Clarke writes as anticipated?  
Letter to go from you rather than CST?*

*25/9/88*

### BRITISH SHIPBUILDERS: PRIVATISATION

Mr Clarke will write to you tomorrow seeking ~~clearance~~ clearance for part of the deal by which the Govan yard may be disposed of to the Norwegian shipping company, Kvaerner. He would like a reply tomorrow, to allow negotiations to proceed over the weekend. I attach the draft letter which he has been given to send. This submission recommends a line to take tomorrow in the event that what he writes has the same substance as the draft by his officials. This submission ~~covers~~ covers the specific proposals on redundancy and goodwill payments which Mr Clarke will make, and goes on to discuss the way that the total deal is shaping up.

### Redundancy and Goodwill Payments

2. The part of the deal which DTI want to be cleared tomorrow concerns what the Govan workforce will get out of the disposal. Kvaerner want them to be squared, on terms acceptable to Kvaerner as far as future operations go, before Kvaerner will proceed with final negotiations for the acquisition. Since Kvaerner ~~are~~ BS should pay for the costs of sweetening the workforce, as part of the dowry they will require to relieve us of this yard, we and BS have an interest in what those costs are. We think it is unavoidable that the dowry to Kvaerner will make some allowance for costs of this sort.

*are existing  
but, as  
in previous  
shipyard  
disposals*



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3. Kvaerner and BS are negotiating with the Govan unions over the weekend, as a prelude to BS/Kvaerner negotiations later next week, following which BS should be able to propose a disposal package to DTI. DTI want to mandate them to negotiate with the unions that all employees at Govan should receive a payment of up to £1,000 as a douceur for working for Kvaerner, in addition to any redundancy which may be payable. Kvaerner plans to make 500 of the workforce redundant. At the moment the offer is £750 a head deductible from any subsequent redundancy. This offer was tabled without our approval. BS want authority now to improve the offer up to the limit above to clinch a deal on Saturday.

4. The draft letter also notes that it is envisaged that in addition to paying for this douceur on behalf of Kvaerner, BS will reimburse Kvaerner for the costs of any redundancies over 18 months from the disposal up to a limit of 500 individuals. During this period existing BS terms and conditions of service, including redundancy, will run on. The douceur and the redundancies could cost some £7.5m in total.

5. At official level we have made the following points to DTI:

(a) it is reasonable for Kvaerner to establish what the workforce will want;

(b) it is open to Kvaerner to propose what they like to BS about who pays for it, in the context of the overall package which Kvaerner requires;

(c) but BS/HMG should not be signing up to individual elements of the disposal package as though they were independent of other elements;

(d) therefore it is meaningless to say to Kvaerner that BS will pay for 500 redundancies and douceur up to £1,000 until the whole package is ready for scrutiny.



The total deal

6. We are not at all happy at the way the negotiations for the whole package are shaping up. It now involves a dowry of about £30m plus a very generous deal which effectively guarantees existing levels of IF support until 1993. I attach a note by Mr Rutnam. The remit from the last meeting with the Prime Minister was for dowry elements to be minimised if continuing IF had to be conceded. DTI officials are concocting a deal in which:

(i) the up-front costs to BS, plus the costs of supporting new orders at the yard up to 1993, amount to 'about' the costs of closing the yard;

(ii) there is no obstacle to Kvaerner getting support for orders beyond 1993, at additional cost to Government;

(iii) Kvaerner is assured that support for orders up to 1993 will effectively be delivered at 28 per cent of cost even if during that period support limits are reduced below 28 per cent. If, say, EC support limits reduced progressively to zero by 1993, this guarantee could be worth about £30m to Kvaerner.

7. We think this is not very good. The support elements of the package would be better if Kvaerner were told that orders at Govan would be considered for support on the same footing as other eligible GB yards. And the up-front costs could surely be reduced. The douceur is very generous considering that the alternative faced by the workforce is the dole.

8. We recommend that you take the following line with Mr Clarke:

(a) we should not sign up to bits of the deal independently of other bits;

(b) therefore very uneasy about his proposal without its context;

(c) since negotiations have already started with unions



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without reference to colleagues, reluctantly accept they should proceed.

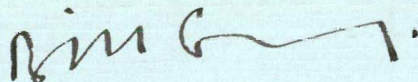
(d) but must be on basis only of exploring what unions would want if deal done with Kvaerner.

(e) Kvaerner must understand that they are responsible in the sense that eg extravagant goodwill payments will mean they will get less in other elements of the package, ie. employee goodwill/redundancy is not an independent variable;

(f) surely £1,000 goodwill, non-deductible, is too high. Unions in very weak position to demand anything. If not careful all they will get is £12,000 a head redundancy. If unions sabotage the deal by being greedy, they must live with awful consequences.

(g) want to see from Mr Clarke early next week the way the whole deal is shaping, with his views, before negotiations are finalised. Treatment of support for new orders very sensitive. If open to Kvaerner to get continuing support for orders, should not be on terms more advantageous than generally available. And should take account of long term costs of support in comparing disposal costs with closure costs. [Not for use: we believe that Mr Clarke has not been briefed on the detailed negotiations on the total package yet.]

9. If you agree with this general line, we can provide a draft letter as soon as we see Mr Clarke's, but if time is tight it might be necessary for your office to speak to his.



W GUY



**DRAFT**

Addressed to:

CONFIDENTIAL  
COMMERCIAL IN CONFIDENCE

Rt Hon John Major Esq  
Chief Secretary  
H M Treasury  
Parliament Street  
LONDON  
SW1

**File No.**

Copies to:

PS/SoS  
PS/Mr Atkins  
PS/Sir B Hayes  
Mr Williams  
Mr Benjamin EM  
Mr O'Shea FRM1  
Dr Pelling EM6a

Originated by:

(Initials and date)

  
DRC

Seen by: 9.6.88

(Initials and date)

Enclosures:

Type for signature of

..... CDL .....  
(Initials and date)

DEPARTMENT OF TRADE AND INDUSTRY

BRITISH SHIPBUILDERS

Both we and Kvaerner have a strong interest in concluding an early agreement on the disposal of Govan if suitable terms can be negotiated. The parties hope that meetings arranged for 15 and 16 June will put them in a position to make recommendations. The signs are that it will prove possible to reach agreement consistent with the mandate we have agreed.

I shall of course write to you with details as soon as BS make a recommendation. Meanwhile my Officials will remain in close touch with yours. However, there is one point on which I should be grateful for your agreement now. This concerns the redundancy



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File No.

arrangements Kvaerner are looking to BS to fund.

Kvaerner's approach in the negotiations has been to look to BS to provide the means to leave them with a shipyard that should at least not make losses. In return they accept the risk of achieving the substantial improvements in efficiency that are also required to achieve this. They have therefore made clear their Board could not contemplate a deal before prior agreement with the workforce had been achieved. For this reason, their team is most reluctant to enter what may be final negotiations with BS next week without this prior agreement and BS would prefer to know what the manpower part of the package is likely to cost before agreeing to other elements.

Following preliminary presentations about their business, Kvaerner had a first substantive discussion with the Govan Shop Stewards and Convenors and the National Shipbuilding Union Representatives on 2 June. Following consultations here, of which your Officials were aware, Kvaerner tabled proposals offering to maintain the present BS redundancy and lay-off arrangements until July 1990 in the full expectation of a work programme that would take them beyond that date, without which the deal will not go ahead. In consequence BS would/<sup>only</sup> be responsible for redundancy payments to the initial reduction in 500



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File No.

employees.

Kvaerner also tabled a good will payment of £750 per employee in return for Union agreement to reduce manning from 1850 to 1350 to be completed within three months of the completion of the China ships, with Kvaerner choosing who should go; an end to a three day concessionary holiday arrangement for all employees; payment of all the workforce by cheque on the basis of electronically recorded clocking-on and clocking-off; a reduction in Union representation and time off to attend Union meetings; and no further review of pay conditions before April 1989.

On the 500 redundancies, in previous BS *2 p-works ✓* privatisations we have agreed to cover the whole workforce for up to twelve months. Here we would be covering costs for 500 out of a total of 1850 over eighteen months or so. This seems to me reasonable. The cost would be about £5.5m depending on the actual entitlements of those made redundant.

I also believe we should be prepared to sanction and fund the good will payments and also give the negotiators scope to improve their position, though only within strictly defined limits, stressing to BS and Kvaerner that the more generous any concessions to achieve a compliant workforce, the less scope we



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File No.

3

shall have to support capital investment, under-recoveries during the building of the China ships, and support for new orders. BS and Kvaerner are, of course, are already well aware of this.

In the privatisations of Scott Lithgow and Yarrow also on the Clyde, good will payments of £600 were agreed. The amounts were taxable. At Govan Kvaerner are very concerned to achieve early agreement and believe they are looking for more considerable concessions than either Trafalgar House or GEC. Even in its own terms, the proposed £750 per man is not out of line with concessions generally expected in workforce negotiations despite a general recognition that the future of Govan without Kvaerner is questionable. Quite apart from the reduction in manpower, BS believe that it could cost between £100 and £150 per head in national negotiations to buy electronic recording and automatic payment by cheque; and the loss of holiday benefits worth £100 a year or so to skilled men might cost at least £200 to buy-out. It is also well known on the Clyde that Trafalgar House agreed substantial wage increases for higher welding skills shortly after acquisition which Kvaerner have no intention in conceding but need a content workforce in order to achieve this.



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File No.

BS Industrial Relations specialists believe a taxable figure of £750 might just produce a deal, but say that they and Kvaerner would feel far more confident in achieving immediate settlement if they had flexibility to negotiate within a ceiling of a taxable sum of £1000 per man. A concession of this amount would cost £1.8m to BS and £1.4m to the taxpayer since, unlike a redundancy payment, the amount would be subject to income tax.

At present the proposition on the table assumes that any of upfront payment would be deductible from payments made on redundancy. The National Unions have hinted to BS that they might be able to secure Union/<sup>and workforce</sup> agreement on the whole package on Saturday with some concession on the amount and if this good will payment was not deductible from subsequent redundancy benefits. If <sup>both</sup> the concessions were granted, the total cost of the redundancy package to BS at a maximum of £1000 per employee for the good will payment would become £7.35m and to the taxpayer £6.9m.

$$\begin{aligned} & (1300 \times 1000) \\ & + (500 \times 12000) \\ & 7.3m \end{aligned}$$

BS specialists say that if they cannot reach early agreement, the risks are that Union negotiators will begin to press for discussion on individual parts of Kvaerner's requirements, with ~~any~~ serious risk of delaying early agreement. Although the European Commission has said it will do all it can to clear a



(CONTINUE TYPING HERE)

File No.

5

notification of terms before the Summer holiday, which is essential to Kvaerner, all negotiations between ourselves and Kvaerner will have to be completed this month in order to achieve that target.

In the interests of an early settlement and confident negotiations between the Principals, I therefore recommend we should accept these proposals and grant the flexibility indicated above. On the rest of the deal it may be helpful for you~~u~~ to know that Kvaerner have not found the restrictions the Commission placed on the dowry concept acceptable but that discussions on the principles of support are still in progress with my Officials working to move back as far as possible to conventional Intervention Fund support. As expected, Kvaerner are pressing for under-recoveries during the building of the China ships to be made good, and for such capital investment as may be necessary to restructure the yard also to be funded by BS. Since all the numbers are presently fluid, I would prefer not to mislead you with figures, but it does appear we have the makings of a satisfactory deal.

As I say, prior agreement with the workforce is essential. I therefore hope you can look quickly at this first element in the package and agree. I should add that I do not regard this as a precedent



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File No.

for other BS disposals. Manpower arrangements in each of the warshipyard privatisations were negotiated individually.



3702/17

**BS: SALE OF GOVAN TO KVAERNER PROPOSED TERMS OF DISPOSAL**

We have now been told by DTI at official level of the likely terms under which BS's Govan yard on the Upper Clyde might be sold to the Norwegian company, Kvaerner. The details are still far from certain but in broad terms the deal is as follows:

	£m
cash payments to Kvaerner (to be paid through BS) to cover cost of operating yard while existing orders are completed	11
ditto for <sup>up to 500</sup> redundancies made <sup>up after 18 months</sup> before Kvaerner take over yard, and 'goodwill' payments.	7-8
investment by BS in restructuring yard to suit Kvaerner's requirements	10
support for five ships or equivalent built by Kvaerner at yard, to c.1993	63
<b>Total of elements with known cost</b>	<b>91-92</b>

PLUS any continuing Intervention Fund support for orders taken in or after 1993, which will not be ruled out under DTI's proposals.

2. We are unhappy about several aspects of this proposal, and do not believe that it represents good value for the Exchequer. At the Prime Minister's meeting on 31 March (copy of note attached, relevant extracts marked), it was agreed that every effort should be made to avoid a deal based on continuing support from the Intervention Fund (IF). (IF provides support for specific orders, at a level related to the gap between the costs of high-cost UK yards and the prices of the low-cost Far East). It was also agreed, however, that if it was necessary to offer continued IF to secure the disposal this could be done but any other payments to Kvaerner (ie the dowry for the yard) should be minimised. We are unhappy about this proposed deal because:



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- (i) There is no evidence that the dowry element has been minimised. Kvaerner will be compensated for redundancies at Govan, restructuring at the yard, and towards the cost of supporting it while BS's existing order of 2 cargo ships for China is completed. In all, these payments will amount to some £28-29 million.
- (ii) Support will be provided to Kvaerner on the ships it plans to build at Govan between now and 1993 on more favourable terms than under the usual IF subsidies. In particular:
- more of the money may be paid 'upfront' than is usual;
  - DTI does not propose to have any mechanism for clawing back a share of any profits made by the shipbuilder after Government support.\* Under IF as usually operated, the Exchequer recoups half of any such profits to offset the initial cost of the grant;
  - DTI does not seem determined to institute rigorous procedures for checking Kvaerner's cost estimates before providing Government support. This is important because if Kvaerner exaggerates the cost of build a disproportionately high level of support will be provided.\*
- (iii) We are also worried that the whole basis of the **pricing** of these supported orders may not be properly commercial. Orders for four of the five ships are likely to be placed by a consortium in which Kvaerner may itself have a controlling interest.

\* This is particularly risky in this case given that Kvaerner will be building ships for a buyer consortium in which Kvaerner itself will have the majority share.



**CONFIDENTIAL**  
**COMMERCIAL IN CONFIDENCE**

iv) The deal as structured will provide Kvaerner with support until 1993 guaranteed to be at 28 per cent of the cost of building the ships, despite the fact that the usual level of IF support may well decline substantially over the same period. DTI officials have before now suggested that the levels of support may fall from 28 per cent by 7 per cent a year. If this does turn out to be the case, the cost of subsidising the ships to be built by Kvaerner <sup>under normal IF</sup> would fall from the £63m DTI predict to £30-40m.

3. DTI claim at official level that this deal closely resembles a deal based on a dowry, which it was agreed should be sought at both the Prime Minister's meeting on 31 March and at E(A) on 10 May. Because continuing support after 1993 is specifically not going to be ruled out, this is clearly not so. This would be a deal based on continuing support plus substantiated cash payments to or on behalf of the Kvaerner. DTI also claim that by discounting the various elements the total known cost (the £91-92 million) depending on when payments will be made, the net present cost of the deal is <sup>close</sup> to £75 million. It was agreed at the Prime Minister's meeting that this should be the control total for negotiation on dowries. We have seen no calculations, and are not happy with the suggestion that this expenditure should be controlled by reference to its net present cost rather than cash.

4. If the disposal is dependent on the terms outlined above, it would probably be cheaper to shut the yard under BS ownership. But while this may be the preferred option purely on expenditure grounds, you will probably feel that the political head of steam behind disposal is such that it is futile to challenge the policy. In any case, you will certainly wish to press Mr Clarke for a full account of the proposed terms of sale in your reply to his forthcoming letter. This will be reflected in the draft reply for you to send tomorrow.



P M RUTNAM





10 DOWNING STREET  
LONDON SW1A 2AA

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

SECRET

05 APR 1988

Mrs Bacon  
CST, FST, SU PM, Middle  
Mr Anson, Mr Monck  
Mr Moore, Mr Butler  
Ms Seaman, Mr Wells  
Mr A White, Mr R Egan  
Mr Guy, Mr Sharatt  
Mr N Williams  
31 March 1988  
Mr Lubran  
Mr Call



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 £ 5 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 Tikkoo 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.

Yes,

Paul

(PAUL GRAY)

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



CONFIDENTIAL



FROM: J M G TAYLOR

DATE: 10 June 1988

*pmf*

PS/CHIEF SECRETARY

cc PS/Financial Secretary  
Sir P Middleton  
Mr Anson  
Mr Monck  
Mr Moore  
Mr Burgner  
Mrs Brown  
Mr A M White  
Mr Waller  
Mr Rutnam  
Mr Guy  
Mr Call  
Mr Tyrie

**BRITISH SHIPBUILDERS: PRIVATISATION**

The Chancellor has seen Mr Guy's minute of 9 June. He has commented that he does not at all like the way in which the deal is shaping up - in particular the fact that there is a dowry plus an effective guarantee of IF support.

*JMG*

J M G TAYLOR





Inland Revenue

Policy Division  
Somerset House

FROM: I FRASER  
DATE: 14 June 1988

*Ch. A pity that we  
cannot ring-fence. But  
IR/Mod's arguments are pretty persuasive.  
Content to write as proposed?*

- 1. MR LEWIS
- 2. CHANCELLOR

*Seen in draft-*

*OK as  
drafted.  
Had no  
proposals for  
practical,  
lower  
wages  
etc.*

**FINANCE BILL NEW CLAUSE: TAXATION OF SEAFARERS**

- 1. Following the Prime Minister's meeting of 8 June, we have
  - (a) sought urgent views from colleagues in DTP and MOD - who have agreed this submission - on the proposed condition that the extension of the foreign earnings deduction rules should apply only to seafarers who are prepared to join a reserve which would be available for service in wartime;
  - (b) instructed Parliamentary Counsel to draft a new Clause leaving the condition referred to at (a) to be added later, if necessary.

**CONDITION OF JOINING A RESERVE**

- 2. The proposal is that eligibility for the extension of the relief should be conditional upon joining a reserve available for service in wartime. We have considered the proposal from the point of view of

cc Financial Secretary  
 Chief Secretary  
 Paymaster General  
 Economic Secretary  
 Sir P Middleton  
 Mr Scholar  
 Mrs Case  
 Mr Revolta  
 Ms Sinclair  
 Mr A R Williams  
 Mr Cropper  
 Mr Tyrie  
 Mr Call  
 Mr C Jenkins (OPC)

Chairman  
 Mr Isaac  
 Mr Beighton  
 Mr Lewis  
 Miss Rhodes  
 Mr R H Allen  
 Mr O'Brien  
 Mr Fraser  
 Mr I Stewart  
 Mr Jarvis  
 Mr K Allen  
 PS/IR



- (a) how the administration would work;
- (b) whether an appropriate reserve exists;
- (c) what purpose would be served by the condition.

#### ADMINISTRATION

- 3. If the proposed condition was attached to the new relaxed rules, it would be relatively easy for us to administer if the claimant were able to produce a reasonably secure form of proof (probably in the form of identity papers or a certificate from the sponsoring Department) by which we could check that the condition was satisfied.

#### THE RESERVE

- 4. A major problem about the proposed condition is that, at the present time, no such reserve exists. The recent Merchant Shipping Act provided for the creation of a Merchant Navy Reserve. But this does not come into being until April 1989. In addition it is designed not for serving men, but for seafarers who have retired but are still active enough to serve in time of war if necessary.

#### PURPOSE OF THE CONDITION

- 5. More importantly, in time of crisis and war we understand that the availability of serving British Merchant seamen will be ensured under Emergency Regulations. The problem therefore is not one of ensuring that serving British seamen do make themselves available in time of war but that there should not be such a decline in the numbers of British seafarers that there are not enough available to man the ships we need. The proposed



new provision will, in any event, help in that respect.

6. We appreciate that presentationally it would be helpful, in justifying this new relief, to point to a defence related condition. But DTp and MOD officials agree that a direct link with membership of a reserve for serving men is not possible, and they believe that such a condition is also unnecessary. Although of course details of provisions for an emergency are classified, there might be (mistaken) speculation that such plans were inadequate if we promoted this relief based on a condition designed to encourage people to do what most people would assume would be required of them in time of crisis or war anyway.

#### ALTERNATIVE PROPOSAL.

7. We have considered whether it would be practical to link the tax relief to an undertaking by claimants to join the Merchant Navy Reserve when they eventually leave the sea. This would be much more complicated in practice. It would have to provide for all the circumstances (eg ill health) where it would not be possible to fulfil an undertaking, possibly given many years earlier. In practice such an undertaking could be difficult to enforce (even if, as a matter of policy, the Department of Transport wished to do so).

#### NEXT STEPS

8. The note of the Prime Minister's meeting records agreement that you should consider the practicality of such a condition in consultation with the Secretaries of State for Defence and Transport. If you agree that such a condition should not be included in the Finance Bill New Clause, you will want to write to colleagues and a draft letter is attached. If the New Clause is to



be tabled for Committee Stage a very early decision will be needed. This is reflected in the draft letter.

9. We hope to produce, in the next few days, a note dealing with the need for decisions on timing, informing the GCBS of the new clause and the PAYE decision and on publicity for the new clause. A particular point affecting the timing is the publication next Tuesday of the Report of the Transport Select Committee on the Decline of the UK Registered Fleet.

*I. Fraser*

I FRASER



Completions

DRAFT

The Rt Hon Paul Channon MP  
House of Commons  
LONDON  
SW1A 0AA

**MERCHANT SHIPPING AND DEFENCE: TAX RELIEFS**

1. At the Prime Minister's meeting on 8 June it was agreed that the relaxation of the foreign earnings deduction rules discussed in my paper of 3 June should be implemented in this year's Finance Bill. I was, however, also asked to consider the possibility of making the more generous relief conditional on the seafarer joining a reserve available for service in wartime.
2. I have considered ~~both~~ the practicalities ~~and~~ ~~policy implications~~ of this further proposal following a report to me by the Revenue of discussions with Transport and Defence officials. My ~~clear~~ <sup>clearly</sup> conclusion is that, on examination, this is not ~~an attractive~~ <sup>a practical</sup> proposition. I understand that this is a view shared by officials in both your Department and the Ministry of Defence.

Practicalities

3. It would be relatively easy - as a matter of administration for the Inland Revenue - to make it a condition of granting relief under the specially relaxed rules for the foreign earnings deduction for seamen that evidence be produced of current membership of the reserve (or membership throughout the period of claim).



4. However I understand that the Merchant Navy Reserve for which the recent Merchant Shipping Act made provision does not come into being until next year. Moreover its purpose is to recruit people such as retired seamen who have the necessary skills and experience but are no longer at sea. Such people would not, of course, qualify for the new foreign earnings deduction since they would no longer be working overseas on ships. It follows that a direct and immediate link between membership of a reserve and the claim for tax relief would not be possible.
  
5. It might, of course, be possible to require claimants to give some undertaking to join the Merchant Navy Reserve when they eventually left the sea. But that would be a much more complicated proposition because, for example, provision would have to be made for all the changes of circumstance (eg health, going abroad) which could occur between the claim for tax relief and the point at which the reserve should be joined. It would not be possible to sort out all the details of such a link in the short time available. The main practical stumbling block would probably be enforceability. What would appear to be binding undertakings to join the reserve would, I suspect, in practice turn out to be little more than declarations of intent made at the time. Would you, in practice, want to take these people to Court to compel them to join the reserve if they had claimed tax relief? To the extent that there was a perception that these undertakings would not in practice be enforceable, in many cases at least, the credibility of the whole arrangement would be undermined.



Policy considerations

6. I cannot think of any precedent for making a tax relief dependent on the taxpayer entering into a contractual obligation with the Government to perform some particular service in the future. So such a provision would be likely to be criticised as quite out of keeping with the tax system.
7. I think there would also be criticism from other groups of seafarers. On the one hand, since those who are already exempt (because they are non-resident or qualify for the foreign earnings deduction at present) would not have to give any undertaking about joining a reserve, those who wished to gain the benefit of the more generous relief might well feel that that was a heavy obligation, imposed unfairly on them. On the other hand, there would be many seamen working in UK waters who would be vital for the defence effort, and who are at present fully liable to UK tax, who might reasonably ask why they too should not be given an opportunity to achieve a UK tax exemption by undertaking to join a merchant navy reserve when they retire.
8. ~~This points to the need to be clearer about our defence/shipping objectives.~~ *It also needs to be clear* We originally saw this relaxation as directed primarily towards the shipping companies, to help them, indirectly and to an uncertain extent, with their crewing costs. To the extent that this is effective, this should slow down the reduction in the numbers of serving British seafarers as well as helping to keep ships on the UK/IOM registers.
9. But the proposed condition would be more directed towards ensuring the availability of serving seamen in time of crisis or war. I understand



that this availability will, in any event, be ensured by Emergency Regulations, so linking it to a tax relief is unnecessary. As for compelling seamen to join the reserve in the future - even if the practicalities could be sorted out on a longer timescale - the question is do we want this reserve to be composed (uniquely) of "pressed men" rather than genuine volunteers?

#### CONCLUSION

10. As will be clear from the above, I do not think the suggested ring-fencing of the relaxation is ~~either practical, or necessary.~~
11. If the new rules are to be introduced, as we have agreed, at the Committee Stage of the Finance Bill, a new Clause will have to be tabled within the next few days. Drafting is already in hand on the other aspects but we must settle this additional point very shortly. If possible, I would like to table the new clause at the end of this week if it is ready. So could I please ask you and recipients to let me know by Friday, lunchtime, at the latest, if you see any objection to my tabling the new clause then without the ring-fencing condition?
11. I am copying this letter to the Prime Minister and to George Younger.

NIGEL LAWSON





Financial Secretary  
 Chief Secretary  
 Paymaster General  
 Economic Secretary  
 Sir P Middleton  
 Mr Scholar  
 Mrs Case  
 Mr Revolta  
 Ms Sinclair  
 Mr A R Williams  
 Mr Cropper  
 Mr Tyrie  
 Mr Call  
 Mr C Jenkins (OPC)  
 Mr Battishill - IR  
 Mr Isaac - IR  
 Mr Beighton - IR  
 Mr Lewis - IR  
 Mr I Fraser - IR  
 PS/IR

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

15 June 1988

The Rt Hon Paul Channon MP  
 House of Commons  
 LONDON SW1A 0AA

**MERCHANT SHIPPING AND DEFENCE: TAX RELIEFS**

At the Prime Minister's meeting on 8 June it was agreed that the relaxation of the foreign earnings deduction rules discussed in my paper of 3 June should be implemented in this year's Finance Bill. I was, however, also asked to consider the possibility of making the more generous relief conditional on the seafarer joining a reserve available for service in wartime.

I have considered the practicalities of this further proposal following a report to me by the Revenue of discussions with Transport and Defence officials. My reluctant conclusion is that, on examination, this is not a practical proposition. I understand that this is a view shared by officials in both your Department and the Ministry of Defence.

It would be relatively easy - as a matter of administration for the Inland Revenue - to make it a condition of granting relief under the specially relaxed rules for the foreign earnings deduction for seamen that evidence be produced of current membership of the reserve (or membership throughout the period of claim).

However I understand that the Merchant Navy Reserve for which the recent Merchant Shipping Act made provision does not come into being until next year. Moreover, its purpose is to recruit people such as retired seamen who have the necessary skills and experience but are no longer at sea. Such people would not, of course, qualify for the new foreign earnings deduction since they would no longer be working overseas on ships. It follows that a direct and immediate link between membership of a reserve and the claim for tax relief would not be possible.

It might, of course, be possible to require claimants to give some undertaking to join the Merchant Navy Reserve when they eventually left the sea. But that would be a much more complicated





proposition because, for example, provision would have to be made for all the changes of circumstance (eg health, going abroad) which could occur between the claim for tax relief and the point at which the reserve should be joined. It would not be possible to sort out all the details of such a link in the short time available. The main practical stumbling block would probably be enforceability. What would appear to be binding undertakings to join the reserve would, I suspect, in practice turn out to be little more than declarations of intent made at the time. Would you, in practice, want to take these people to Court to compel them to join the reserve if they had claimed tax relief? To the extent that there was a perception that these undertakings would not in practice be enforceable, in many cases at least, the credibility of the whole arrangement would be undermined.

**CONCLUSION**

As will be clear from the above, I do not think the suggested ring-fencing of the relaxation is practical.

If the new rules are to be introduced, as we have agreed, at the Committee stage of the Finance Bill, a new clause will have to be tabled within the next few days. Drafting is already in hand on the other aspects but we must settle this additional point very shortly. If possible, I would like to table the new clause at the end of this week if it is ready. So could I please ask you and recipients to let me know by Friday, lunchtime, at the latest, if you see any objection to my tabling the new clause then without the ring-fencing condition?

I am copying this letter to the Prime Minister and to George Younger.

A handwritten signature in black ink, appearing to read 'Nigel Lawson', written over a horizontal line.

**NIGEL LAWSON**





DEPARTMENT OF TRANSPORT  
2 MARSHAM STREET LONDON SW1P 3EB

My ref: C/PSO/7460/88

Your ref:

*Handwritten signature/initials*

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

CH/EXCHEQUER	
REC.	16 JUN 1988 ✓ 16/6
ACTION	MR I FRASER IR
COPIES TO	FST, CST, PMG, EST SIR P MIDDLETON MR SCHOLAR, MRS CASE MR REVOLTA, MR GILHOOLY MR A P WILLIAMS, MR CROPPER MR TYRRE, MR CALL MR C JENKINS (OPC) MR BATTISHILL IR, MR ISAAC IR

MR BEIGHTON IR 11.6 JUN 1988  
MR LEWIS IR PS/IR

*Dear Nigel.*

**MERCHANT SHIPPING AND DEFENCE: TAX RELIEFS**

Thank you for your letter of 15 June.

The practical arguments against tying the relaxation of the FED relief to a commitment to serve in wartime are very strong. Moreover, I am advised that we already have adequate powers to ensure the availability of British seamen in a time of crisis. I therefore fully support your proposal not to ring-fence the relaxation. The announcement of this change will be of major interest to the industry and will need careful handling with the Commons Transport Committee, whose report on shipping and defence is due to be published on 21 June. I understand that our officials are in touch about the arrangements for making the announcement.

I am sending a copy of this letter to the Prime Minister and to George Younger.

*Handwritten signature of Paul Channon*

PAUL CHANNON



CONFIDENTIAL



10 DOWNING STREET  
LONDON SW1A 2AA

CH/EXCHEQUER	
REC.	20 JUN 1988 ✓ 20/6
ACTION	Mr I FRASER IR
TO	EST, CST, PMG EST, SIR P M DOLETON, MR SCHOLAR, MRS CASE MR REVOLTA, MS SINDLAR MR AR WILLIAMS, MR COOPER MR TYRRE, MR CALL
	17 June 1988

From the Private Secretary

Dear Alex,

MR C JENKINS (OPC)  
MR BATTISHILL IR.  
MR ISAAC IR,  
MR BEIGHTON IR,  
MR LEWIS IR  
PS IR

**MERCHANT SHIPPING AND DEFENCE: TAX RELIEFS**

The Prime Minister has seen the Chancellor's letter of 15 June to the Secretary of State for Transport. She is content for the new clause of the Finance Bill to be tabled without the ring-fencing condition.

I am copying this letter to the Private Secretaries to the Secretaries of State for Transport and Defence.

*Yes,  
Paul*

PAUL GRAY

Alex Allan, Esq.,  
H M Treasury

CONFIDENTIAL



CONFIDENTIAL

FROM: W GUY

DATE: 21 June 1988

- 22/6  
1 MRS BROWN  
2 CHIEF SECRETARY

Ch/A last-minute bounce  
from Mr Clarke. Officials  
have produced advice in great  
hurry, hence manuscript. CST  
wd like to know your views,  
if possible. mfgw 21/6

cc:  
Chancellor  
Financial Secretary  
Sir Peter Middleton  
Mr Anson  
Mr Monck  
Mr D J Moore  
Mr Burgner  
Mr Waller  
Mr A M White  
Mr Ramsden

#### BRITISH SHIPBUILDERS: SALE OF GOVAN TO KVAERNER

Mr Clarke has now (9.00pm tonight) replied to your letter of 10 June requesting urgent advice from him on how the deal with Kvaerner is shaping up, so that you could comment before it was too late to change it. He would like a reply by lunchtime tomorrow, as negotiations with Kvaerner are planned to conclude tomorrow afternoon. This is a bounce which he may find difficult to defend if you object, especially given your letter, and the fact that his officials were instructed by him not to let Treasury officials see the draft of tonight's reply.

2 The deal which he describes is not in our view a good one. But given the tone of collective agreement reached earlier on the Govan disposal you will wish to consider how far to go in challenging it.

#### The Proposed Deal

3 The basic structure of the proposed deal is:

Dowry to Kvaerner of up to £27m

Guaranteed Intervention Fund £37m

Total cost up to £65m



These figures are in present value terms. In cash, the total cost could be £75 million. It is intended to dribble out the parts of the dowry for redundancy as it occurs and for investment in restructuring berths, etc, as the underlying work is done, and the IF would also be phased.

4 Mr Clarke is minded to add about £1 million to the cost to clinch a deal: Kvaerner are seeking an extra £6 million.

5 DTI are comparing the £65/£66 million with estimated closure costs of £90 million. (The original control total of £75 million for a dowry without IF represented the costs within the £90 million which could be avoided by a sale to Kvaerner.) They and their merchant bank advisers (BZW) say it is a good deal and one which is consistent with the remit from the Prime Minister and E(A) to offer Intervention Fund support to Kvaerner but in that case to minimise any dowry elements in the package.

6 We believe it is not such a good deal, because

- (a) it makes no allowance for costs of Intervention Fund beyond 1992; and
- (b) it represents a very generous form of IF up to 1992.

These points are explained below.

### Intervention Fund

7 The estimated cost of £37 million for IF support relates to new orders for four ships which Kvaerner would put in the yard to keep it busy up to 1992. It is calculated at 28 per cent of build costs, which is the prevailing EC maximum.



It would, in theory, not give Kvaerner any profit, as the purpose of IF is just to keep yards in business against competition from lower cost <sup>fav</sup> ~~for~~ East yards, and if 28 per cent implied a profit, the support for the orders should be lower.

8 It would be difficult to tell if Kvaerner were making a profit or not, since the ships would incorporate a unique gas carrying technology making comparisons with competitors' prices difficult or impossible and because the contracts will not be arms length - the customers would be a consortium in which Kvaerner itself has the major stake.

9 In fact DTI are proposing not to bother much to check to see if Kvaerner make a profit from the £37 million IF on these four ships. The deal includes the right for Kvaerner to keep any profit they make. Under normal IF rules they would have to surrender half of any profit which unexpectedly materialised. This is <sup>the reverse</sup> ~~before~~ a potentially generous form of 'super IF'. But it is impossible for us to say exactly how generous.

10 Beyond these four ships, which should see Govan busy up to 1992, Kvaerner would be eligible for IF on the same basis as other UK yards. DTI present this as <sup>Cost less</sup> ~~costly~~ because they assume that the EC will have eliminated contract support ~~for~~ of this sort by then. We think this is a highly questionable assumption. The Commission has not, to date, been successful in reducing the 28 per cent maximum under the Sixth Directive. It is an act of faith to assume that they will be more successful under a new Directive.

11 DTI ~~be~~ believe that the Commission will prevail in the light of a recovery in the world shipping market, which they expect to reach a cyclical peak in the early or mid 1990s. There are some signs of a recovery in shipping prices, but there are also signs that capacity will be increased in the Far East to meet the upswing. We regard it as optimistic to believe



that

- (a) the market will peak in time for the Commission to justify a reduction in support maxima to zero before Kvaerner seek IF on their fifth and successive new order at Govan in 1992;
- (b) the cost-price gap with the Far East will not remain at the time of the next cyclical peak, because of emergent new low cost capacity in the Far East. If the gap remained, the Commission would find it hard to justify elimination of support;
- (c) other member governments will acquiesce in Commission proposals for the elimination of support.

12 Moreover, even if support were eliminated at the time of the next market peak, whenever that came, there would be the spectre of support reappearing afterwards.

13 For all these reasons we believe, DTI must recognise the risk of IF/ Costs at Govan beyond 1992. They do not wish to do so because the costs could be very high, upsetting the comparison between the Kvaerner deal and the costs of closing Govan under BS ownership. For instance, only £5 million a year for 10 years has a present value of about [£40 million]. This would be enough to push the costs of the Kvaerner deal above closure costs.

### Tactics

14 You will wish to consider tactics against the near certainty that Mr Clarke will appeal to the Prime Minister and colleagues if you reject his proposal tomorrow. DTI have created a climate of expectation that Govan will be privatised, and you are bound to be accused of sabotage if you intervene to object to the deal. You can rely on Mr Rifkind to argue strongly for a deal with Kvaerner, as he will not be paying for it.



15 On the other hand you did write eleven days ago expressing disquiet at the sort of deal which Mr Clarke has now put forward. You ~~showed~~<sup>stressed</sup> the importance of getting the dowry down to well below £30 million. You warned that longer term IF costs would need to be taken into account; you objected to the idea of unusually generous IF for the early new orders; and you queried how IF could be at arms-length prices in this case. You asked for urgent advice from Mr Clarke on how the negotiations were going, so you could comment before it was too late.

16 Mr Clarke's reply has come late on the eve of the final negotiating session. It does not respond satisfactorily to your general concerns, and it proposes a dowry of £27 million, plus 'Super IF' up to 1992 and continuing IF thereafter.

17 Your options seem to be:

(i) accept the deal as proposed;

(ii) attempt to nibble at the costs;

(iii) throw it back to Mr Clarke saying the dowry is far too much.

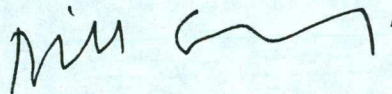
18 The risk of (ii) is that we have no basis for suggesting minor amendments, except the rejection of the extra £1 million which Mr Clarke wants to offer in the form of supporting any alleged overrun in contract costs up to a ceiling. You might also appear to be nitpicking, allowing Mr Clarke to achieve (i) by appealing to colleagues on the basis that only a small amount of money is at issue between you.

19 You have grounds for (iii), but you will wish to consider how this would be received by colleagues. Mr Clarke clearly



feels he could win, and a signal defeat for you would set a bad precedent for other BS yards and Harland and Wolf. On pure expenditure grounds we would recommend (iii) but only if you could win. We recognise that there are other considerations. A draft letter along the lines of (iii) is attached as an illustration, rather than as a recommendation.

20 You may alternatively wish to tell Mr Clarke that this ~~is~~ all too much of a bounce and the final negotiations must be postponed until later this week. This would be unwelcome to DTI, but we understand that the Kvaerner Board will not meet again until Monday to approve a deal anyway. Of course, this approach only delays the decision.



W GUY



DRAFT LETTER TO MR CLARKE

BRITISH SHIPBUILDERS

Thank you for your letter <sup>yesterday night.</sup> ~~of 21 June.~~

I note that you are aiming to give consent to terms for the disposal of Govan later this week and that you aim to conclude negotiations with Kvaerner today.

I am sorry that you were not able to give me more time to comment on your proposal. You will recall that over a week ago I expressed concern over reports of the way in which the negotiations were going, and I asked you urgently to let me have the details so that I could comment <sup>before any deal was signed.</sup> ~~[which there was still time to change things without accusations of bad faith from Kvaerner.]~~

~~I urged you to ensure that in assessing the costs of the deal, you took proper account of Intervention Fund costs beyond ~~the~~ the orders for which support would be guaranteed to Kvaerner, and I said that the~~



At the Prime Ministers meeting on 31  
March and at the subsequent E(A) <sup>meeting</sup> it was agreed  
that continuing Intervention Fund support for orders at  
Govan could be conceded but that the downy  
should then be minimised. It was agreed also  
it was essential that  
that support should be on the basis of arms-length  
prices.

My main concerns about your proposal are that

(i) you have not quantified the costs of  
Intervention Fund support beyond 1992. I see no basis  
for believing that the EC will have ~~reduced~~  
eliminated contract support by then, and without taking  
these costs into account we ~~cannot be sure~~ do  
not have a true picture of the costs of the



deal which you propose;

(ii) although you are proposing open-ended IF, you are proposing in addition a loaning of £27 million; and

(iii) although your letter does not say so, I understand that the deal would provide IF ~~on~~ on the four ships up to 1992 on terms more generous than normal. I <sup>understand</sup> ~~gather~~ <sup>unusually,</sup> that, (there would be no provision for clawing back any profit which

Kvaerner made. ~~This is~~ There is also the related point that without arms length prices it is open to Kvaerner to fix <sup>the</sup> prices <sup>of these ships</sup> so that profits could be made. They will effectively be building the ships for themselves.



In sum, I do not consider that  
your present proposal is in accordance with the  
representative mandate agreed at the [Prime Minister's  
meeting on ~~April~~ 31 March]. I consider that  
intervention fund support, whether before or after  
1992, should be on normal terms, and that  
any dowry should be considerably less than  
the £27m you propose.

I am sending copies of this letter to the  
recipients of yours.

John Major.



*pmp*

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

Rt Hon John Major MP  
Chief Secretary  
HM Treasury  
Parliament Street  
LONDON  
SW1P 3AQ

CH/EXCÉQUER	
REC.	22 JUN 1988 ✓ <i>22/6</i>
ACTION	<i>CST</i>
COPIES TO	

Department of  
Trade and Industry

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London SW1H 0ET

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01-215 7877

Telex 8811074/5 DTHQ G  
Fax 01-222 2629

Direct line 215 5147  
Our ref  
Your ref  
Date 21 June 1988

*1. J. copy*  
*2. pmp*

*Dear John,*

**BRITISH SHIPBUILDERS**

BS and my officials are meeting Kvaerner tomorrow afternoon to discuss final details for their purchase of the Govan yard. This letter seeks your agreement to the terms on which I propose the negotiations should be concluded.

You will recall that earlier this year we agreed to aim for a sale on the basis of no more Intervention Fund support and a dowry of up to £90m. The £90m comprised £15m for under-recoveries and redundancy costs which Kvaerner would expect BS to face over the first 18 months and a dowry of up to £75m to be paid in cash, mainly to cover future support for new orders in place of continuing IF support but also to meet other initial costs. My officials persuaded Kvaerner to negotiate on this basis. Subsequently, however, the European Commission imposed restrictions on the dowry concept and colleagues were not persuaded that we should bring an early end to IF support. Accordingly, E(A) agreed that negotiations with Kvaerner should be pursued on the alternative basis of continuing IF support but with a much reduced dowry.

JE3ABA





the department for Enterprise

Against the original mandate of a total cost of £90m, BS and my officials expect to be able to agree to a total package of approximately £75m. Indeed, even if one were to set aside the £15m for under-recoveries and redundancies originally contained in the £90m, the package still compares favourably with the dowry of up to £75m. This dowry was to be paid in cash up front. The present package, however, will be spread over the period to 1993. On a discounted basis, it has a value of approximately £65m.

The details of the proposed package are set out at Annex A. The negotiations have been conducted on the basis of present value calculations. The main elements of the present value total of £65m are £37m IF support and £27m to meet Kvaerner's initial costs. The principal outstanding issue is a request from Kvaerner for an additional £6m to be paid up front in cash to offset the risk through their failing to secure an order for a fifth ship which they had envisaged at the time they opened negotiations with us. If they had secured this order they would have pressed for additional IF support with a present value in excess of £11m. Without the order they have considerable doubts about their forecasts of cost recovery. It can be argued that the risk is something Kvaerner should face given they will only be bearing a small proportion of the total costs of turning Govan round. I am therefore not prepared to agree to anything like the £6m up front which Kvaerner have requested. There are, however, major risks that Kvaerner will still have to face and for which they had expected to be covered when the negotiations began. I have therefore instructed my officials, if it is absolutely necessary to conclude a deal, to be prepared to offer a final concession provided it does not exceed a present value of £1m. I have also insisted that this should only be offered in a form which is conditional and involves a clear incentive on Kvaerner to perform. This would bring the total package to £65m present value or a little over £75m in cash.

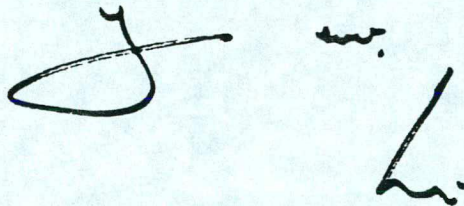
I hope you and colleagues will agree that this is a satisfactory outcome. The terms I am recommending are well within the limits agreed by colleagues. The sale will provide the first tangible justification for our decision to seek to dispose of the BS merchant yards. We will avoid any trade difficulties with China and we will secure inward investment by a major engineering company which brings with it the prospect of further investment and employment. My own strong preference would still have been to have brought IF support to a clear end. The fact that we will not have achieved this needs to be set against the favourable terms we have otherwise negotiated, but even so I believe the package is a reasonable one.

JE3ABA



I understand BS and their financial advisers would regard a settlement on the basis I have outlined as satisfactory and would intend to seek my formal consent for disposal later this week. I also expect my Department's financial advisers to recommend that the terms are fair and reasonable. Subject to your agreement, I therefore propose to instruct my officials to try to agree final terms in the course of negotiations tomorrow. If they succeed then Kvaerner will seek the approval of their main board at a meeting on Monday 26 June. Subject to their confirmation I would then propose to announce the sale later that day.

I am copying this letter to the Prime Minister, Nigel Lawson, George Younger, Malcolm Rifkind and Tom King and to Sir Robin Butler.

A handwritten signature in black ink, appearing to be 'K. Clarke', written in a cursive style.

KENNETH CLARKE



## COST OF GOVAN CLOSURE AS COMPARED WITH THE LIKELY DEAL

The estimates on which we based the original negotiating mandate were as follows. The figures set aside costs and income associated with the existing China contract which are common to all cases. They did not include the costs of any remedial measures. They were in cash, but most of the costs would be incurred in 1988 and 1989, giving a present value of closure of just over £80m

	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
	-----	-----	-----
	90	15+	up to 75

The deal I am prepared to recommend is as follows

Contribution to under-recoveries	10.4	cash
Contribution to redundancies etc	up to 7.1	present value
Contribution to investment	up to 9.4	present value
Contribution to training	0.3	
less payment for stock	0.25	
	-----	
	up to	27
IF for 4 ships with no further offers likely before 1992	37	
Concession if needed	up to 1	
	-----	
Total	up to 65	present value



KVAERNER NEGOTIATIONS WITH BSInitial Costs

BS have offered to meet Kvaerner's initial costs up to a present value total of £27m. The details remain to be agreed but could emerge as follows:

- (i) £10.4m would be paid up front towards under-recovered labour and overhead costs during the construction of the China ships.
- (ii) Kvaerner are planning a major investment programme, the main element of which is civil engineering work to restructure the present three berths into two to allow them to build very large 75,000 cubic metre gas ships during the 1990's. BS have offered to pay up to a present value of £9.4m with payments conditional on stages of the programme proceeding.
- (iii) £7m for redundancies. Kvaerner plan to make 500 redundant and it was a pre-condition of their taking over the yard that they obtained agreements from the Trade Unions to this programme and a wide range of changes in yard practice. These have been achieved.
- (iv) £300,000 towards the training of the workforce to improved stainless steel welding conditions but BS would charge £250,000 for stock.

Kvaerner would pay only a nominal sum for the yard which would give them some cover in the event of subsequent closure.

Taken together, these figures give the present value total of £27m. Variations may be agreed within the total but the figure is on the table.

Intervention Fund

Moss Rosenberg, Kvaerner's shipbuilding subsidiary which in turn would be Govan's parent, hopes to secure final agreement with the respective Boards of Kvaerner Shipping and their partners to orders for two gas ships of 35,000 and 56,000 cubic metre capacity, together with binding options to be confirmed this year for identical sister ships. This workload would carry the yard until the second half of 1992,



assuming in the meantime the restructuring of the yard takes place. If Yarrow wins the Ministry of Defence competition for the Aviation Support Ship, and Yarrow cite Govan as sub-contractor for the hull, the programme would be pushed forward to 1993. DTI officials have told Kvaerner that they should not expect offers of support for follow-on work other than the usual period before build commences to allow for design work, etc. In short, Kvaerner recognise that no further offers are likely before 1992.

Kvaerner will confirm the build costs and prices for these ships on Wednesday but the total cost is likely to be £160m, implying Intervention Fund support at 28 per cent of some £45m with a present value of £37m.

It is of course very difficult to anticipate what the costs of any support for new orders at Govan might be during the 1990's. The EC Sixth Directive, which ends in December 1990, looks for degressive support. Whatever follows is likely to take the same approach but there are clearly many uncertainties.

#### Independence of Clients

Treasury have queried the independence of Govan's clients. The client for the four ships is a partnership 60 per cent owned by Kvaerner Shipping and 40 per cent by Havtor Management, which represents a number of Scandinavian concerns. Two thirds of Kvaerner Shipping is owned by Kvaerner Industrie, one third is quoted on the Norwegian Stock Exchange. There is strong non-Executive representation on the Board to ensure orders are placed competitively on a world-wide basis.

Whatever its structure, in which Kvaerner Industrie might be expected to have the dominant influence through Kvaerner Shipping and its position in the partnership, it is evident the partnership does not simply follow Kvaerner Industrie's line. And while Kvaerner Industrie plainly sees attractions in returning to shipbuilding as a basis for marketing gas ship technology world-wide, in a narrow sense they could avoid all risk of shipbuilding loss by purchasing from Japan rather than from Govan when any losses at Govan will go straight through to their accounts. DTI regards the position as reasonably safeguarded, especially the intensity of competition from Japan which Govan has evidently been facing.







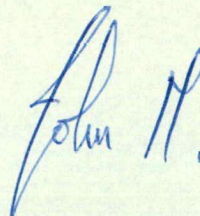
CONFIDENTIAL

3 I saw Kenneth Clarke yesterday evening and told him that I thought the deal was pretty poor. He said that his negotiators have set up this deal on the basis that anything cheaper than the £90 million closedown cost would be broadly satisfactory. I got the impression that he was mildly embarrassed by the outcome.

4 However, I think we now have to accept the deal on offer or reject it and simply let Kvaerner walk away and let Govan close. Kenneth is convinced that no further improvements can be negotiated with Kvaerner. Reluctantly I therefore conclude that we ought to accept since:

- (i) if we torpedo this deal I believe Kenneth Clarke and Malcolm Rifkind will simply take it to the Prime Minister and that she will support them rather than us;
- (ii) it is cheaper than closure though only if we disregard the possibility of IF support post-1992)
- (iii) DTI may just be right about the end to Intervention Fund support post 1992 but it depends on assumptions about the state of world shipbuilding and
- (iv) the margin between this deal and a satisfactory deal does not seem to me to be sufficient to enforce closure with the consequent political difficulties that would cause.

5 Subject to your views I will convey these thoughts to Kenneth Clarke.



JOHN MAJOR



CONFIDENTIAL



FROM: J M G TAYLOR

DATE: 22 June 1988

A large, stylized handwritten signature in the top right corner of the page.

PS/CHIEF SECRETARY

cc PS/Financial Secretary  
Sir P Middleton  
Mr Anson  
Mr Monck  
Mr D J Moore  
Mr Burgner  
Mr Waller  
Mr A M White  
Mrs Brown  
Mr Guy  
Mr Ramsden

**BRITISH SHIPBUILDERS/KVAERNER**

The Chancellor has seen the Chief Secretary's minute of 22 June.

2. He has commented that, since DTI are arguing that there will be no IF support after 1992, we should seek to write this in as part of the deal, irrespective of what the EC decides when the time comes. Subject to that, he is content for the Chief Secretary to proceed as he suggests.

Handwritten initials, possibly 'JMGT', in the bottom right area of the page.

J M G TAYLOR



CONFIDENTIAL

CX  
FST*Sir Peter Middle**Mr Anson**Mr Monck**Mr Budge**Mr Moore**Mrs Brown**Mr Waller**Mr A.M. White**Mr Rutnam.*

Treasury Chambers, Parliament Street, SW1P 3AG

The Rt Hon Kenneth Clarke QC MP  
 Chancellor of the Duchy of Lancaster  
 and Minister of Trade and Industry  
 Department of Trade and Industry  
 1 - 19 Victoria Street  
 London  
 SW1H 0ET

22 June 1988

*Dear Chancellor of the Duchy,***BRITISH SHIPBUILDERS**

Thank you for your letter of 21 June, which I have discussed this morning with Nigel Lawson.

I am sorry that we did not have more time to comment on your proposal. You will recall that on 10 June I asked you to let me know urgently how the negotiations were proceeding so that I could comment before the deal was firmed up. I said then that it was essential that the costs of Intervention Fund support at Govan in the longer term should be taken into account in your costings if it was to be offered to Kvaerner. I said that I doubted that a dowry as high as £30 million could be justified if open-ended IF was to be available. I said also that I thought any IF support to Kvaerner should be on generally available terms, and on the basis of arms length prices as agreed at the Prime Minister's meeting on 31 March.

Your letter does not seem to address these concerns. The further annex which you circulated separately today refers to the costs of IF in the 1990s being uncertain. That does not mean we should ignore them, as your costings do. Also although it is not clear from your letter, I understand that you are proposing an unusually generous form of IF for the first four new orders, which would allow Kvaerner to keep any profit they made on the ships. This seems to me particularly difficult to justify given that the customer for this order will be a consortium in which Kvaerner itself has the major stake. The prices will not therefore be determined at arms length, and



CONFIDENTIAL

there is scope for abuse. I am not at all reassured by the notes on this in your additional annex. My officials are not aware of any evidence for the independence of the consortium and the competition from Japan beyond assertions from Kvaerner themselves.

However my main concern with your proposal is that you have not quantified the costs of Intervention Fund support on the fifth and successive new orders at Govan. This is a critical omission. E(A) agreed that continuing IF could be conceded. But we have to cost it properly before we can decide whether the dowry you propose is too high, compared with the £90 million estimate of closure costs. Unless contract support for UK yards had been completely eliminated before further orders were placed, the costs could be very large. For instance, if in 1991 or 1992 Kvaerner placed new orders with building costs of £100 million and the support regime was still at 28 per cent, this alone would push the costs of the Kvaerner deal above your estimate of closedown costs.

Unless, therefore, we can be confident that there will be no Intervention Fund costs beyond the £37 million you identify, the numbers in your letter will not give us a true picture of the costs to which your proposal would expose us.

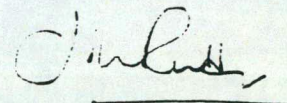
It is only reasonable to exclude the longer term IF costs if you believe that contract support for UK yards will have been eliminated before Kvaerner could seek support for further orders. I am extremely sceptical that the European Commission could achieve this change in policy through EC regulations in that time. They may have a degressive aim under the sixth directive, but they have not achieved any reduction in the support maximum under it so far. Confidence in your costings must therefore rest on the assumption that the UK regime will vary unilaterally within the EC maximum and that regardless of what the EC decides there would be no support for further orders at Govan.

On this basis, I feel I must ask you to reconsider either reducing the size of the dowry, or the possibility of placing a cap on the rate at which Intervention Fund support is payable after 1991 - if the EC has not eliminated it by then.

I should be glad to have a word if necessary in the margins of Cabinet tomorrow.

I am copying this letter to the Prime Minister, Nigel Lawson, George Younger, Malcolm Rifkind and Tom King and to Sir Robin Butler.

Yours sincerely,



pp JOHN MAJOR

(Approved by the Chief Secretary  
- 2 a - in his absence)





SCOTTISH OFFICE  
WHITEHALL, LONDON SW1A 2AU

Rt Hon John Major MP  
Chief Secretary  
HM Treasury  
Parliament Street  
LONDON  
SW1P 3AQ

CHIEF SECRETARY	
REC.	22 JUN 1988
ACTION	Mr Guy
COPIES TO	CXFST In Peter Middleton Mr Anson Mr Monk Mr Bagnall Mr Moore Mrs Brown Mr Waller Mr AM White Mr Rutnam.

22 June 1988

Dear John,

**BRITISH SHIPBUILDERS**

I have seen a copy of Kenneth Clarke's letter of 21 June seeking your agreement to the terms for disposal of Govan Shipbuilders to Kvaerner Industries.

I think it is a creditable achievement to have reached a position where disposal is possible, and though the cost is clearly high it remains less than closure cost, and is within the limits we agreed as acceptable in the spring. As a result, we shall continue to have a working shipyard with a substantial workforce in an area of continuing high relative unemployment for the foreseeable future at less cost than any of the alternatives, with the added prospect of new high technology development. I recognise Kenneth's views on Intervention Fund, but we may look forward, as he indicates, to reductions in the European ceiling of support, and I would not regard this concession as one which need cause concern.

I very much support Kenneth's proposals, and I would urge you to agree as quickly as possible.

Copies of this letter go to the Prime Minister, Nigel Lawson, George Younger, Tom King and Kenneth Clarke and to Sir Robin Butler.

*Yours ever,*  
Malcolm Rifkind

MALCOLM RIFKIND



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

Rt Hon John Major MP  
Chief Secretary  
HM Treasury  
Parliament Street  
LONDON  
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CHIEF SECRETARY
Mr Gray
Ex, FSI, Sir P Middleton
Mr Hanson, Mr Menck
Mr Burgess, Mr Moore
Mrs S Brown, Mr A White
Mr Rutnam, Mr Call

Department of  
Trade and Industry

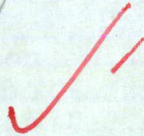
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Direct line 215 5147  
Our ref  
Your ref  
Date 23 June 1988

*Mr John*



## BRITISH SHIPBUILDERS

Thank you for your letter of 22 June. As a result of the further negotiations which took place between British Shipbuilders, my officials and Kvaerner yesterday, I am able to provide assurances on a number of the points you raise. First, however, you will wish to be aware of developments in the proposed financing package.

The annex to my letter of 21 June explained that the build costs of the first four ships remained to be confirmed but were likely to be £160m, implying Intervention Fund support with a present value of £37m (£45m cash). In the event, Kvaerner presented detailed costings totalling approximately £175m, implying IF with a present value of £43m. The costings were scrutinised by BS and my officials who had to concede that they were fully justified and to have withheld support at 28% would have meant going back on our decision to offer IF at current levels. Against this we were, however, able to negotiate a reduction of £2m in present value in the contribution to the investment programme and did not have to use any of the £1m final concession I thought might have been necessary. The result, in present value terms, is a total package of £68m compared to the original mandate of £80m.





the department for Enterprise

Turning to the points in your letter, you will wish to note that, as a result of a further concession extracted in the final negotiations, the IF terms we are proposing are entirely conventional, with no generosity for the first four new orders from Kvaerner. You state that the prices will not be determined at arms-length and that there is scope for abuse. As I explained in the annex to my previous letter, there is a significant degree of scrutiny of orders both through the non-executive members of the Kvaerner Shipping Board as well as by Havtor Management, the partner in placing the orders. More importantly, however, we yesterday secured Kvaerner's agreement to an independent scrutiny by a firm to be appointed by my Department of their comparative prices from overseas yards as well as a post-audit check of the costs of building the ships. Any over-estimate identified as a result of these checks will be clawed back and Kvaerner will only be able to keep one half of any productivity gains that will be achieved.

You expressed concern that the costs of IF support of future orders at Govan is not quantified. My letter did of course draw specific attention to this. I can assure you that we have avoided making any commitment to Kvaerner as to the availability of future IF support. All that we have been prepared to agree to is that we would look at any applications they might make in the light of whatever regime exists in the UK at that time. It will therefore be for decision in due course whether we continue to be guided by whatever European Commission limit exists or, as you say, act unilaterally.

I have to say that I do not regard this as a particularly satisfactory deal. As I have made abundantly clear throughout, my preference has been to bring IF support to an early end. In the event, however, we have a proposal which, as Malcolm Rifkind notes in his letter of 22 June, will leave us with a continuing industry employing a substantial workforce in an area of high relative unemployment. As I said in my previous letter, we will also avoid any trade difficulties with China and there is the prospect of further investment in future by a major engineering company.

I am copying this letter to the Prime Minister, Nigel Lawson, George Younger, Malcolm Rifkind and Tom King and to Sir Robin Butler.

KENNETH CLARKE

JE3ACI

*p.s. This deal is not in the form which you and I always agreed upon as our first choice but I think it is the best we can achieve under the circumstances*



CONFIDENTIAL

FROM: W CUY  
DATE: 24 JUNE 1988

CHIEF SECRETARY

cc Chancellor  
Financial Secretary  
Sir P Middleton  
Mr Anson  
Mr Monck  
Mr Moore  
Mr Burgner  
Mrs Brown or  
Mr Waller  
Mr Rutnam

**BRITISH SHIPBUILDERS**

Miss Rutter asked for a draft letter for you to send to Mr Clarke confirming your agreement to the Kvaerner deal.

2. The important thing now is to stop the Kvaerner costs going up any more, and to avoid being pointed into a corner on disposal of the other yards.

3. On Tuesday night, Mr Clarke was saying that Kvaerner wanted another £6 million but he would not give them more than £1 million. On Thursday morning he was justifying an extra £3 million for Kvaerner.

4. The £3 million net addition came about from a reduction in the dowry which was exceeded by an addition to the quantified IF costs in the first four ships. Kvaerner just said they were going to cost more to build than they had thought earlier. You will wish to be protected against Kvaerner upping the costs again when they eventually come to apply for the IF.

5. We also need protection against the Govan saga being repeated in the cases of other BS yards, of which the biggest is NESL. It would be all too easy to get into the position again of colleagues deciding that privatisation is the highest priority, and that it



is OK to cost the disposal on a basis which underestimates or just ignores the costs of IF in the package. Kvaerner must have known how vulnerable the DTI was to the threat that they would just walk away. To avoid being held to ransom for NESL, it has to be clear that the Government is quite prepared to close it if disposal costs are too high.

6. In one way the Govan deal makes a tough line on other yards more defensible. Govan can be said to show that the Government is prepared to do a 'good' deal on NESL and <sup>so if a deal</sup> others is rejected it must be a bad one. But on the other hand there will be the "if you did it for them, why not for us?" argument.

7. I therefore think it is worth your letter to Mr Clarke (a) reminding him that you think the Kvaerner deal was rotten; (b) warning him against letting it get worse; and (c) taking a stand against any more deals like it eg, at NESL.

*W Guy*

W GUY



**DRAFT LETTER TO MR CLARKE**

**BRITISH SHIPBUILDERS**

Thank you for your letter of 23 June.

I am not unsympathetic to the problems you have faced in arranging the privatisation of Govan, and I welcome the improvements which your negotiations were able to ~~leave~~<sup>secure</sup> in the final session. But I have to say that I do not think that the deal with Kvaerner is very good for our taxpayers in the longer term.

I agree with you that the costs of the Intervention Fund beyond the first four orders are bound to be uncertain, but I think you understand my scepticism about the likelihood of them being nil unless the UK regime were to vary unilaterally. I am also uneasy about the costs of IF on the first four ships, which seem to have jumped significantly in the course of the final negotiations. I hope you will be able to take a firm line limiting support if, later, Kvaerner decide that the build-costs will be higher still.

I think that Kvaerner have done very well for themselves but I fear that if we count the costs in a few years time we shall find that the UK taxpayer has not. However, I quite understand the arguments which you and Malcolm advanced for concluding the deal, and on balance I agree with you that given where we had got to it was better to clinch the deal than to overturn it. Although



my reservations remain, I am prepared to go along with you.

I feel I have to register two concerns for the future, though. First, we must be robust against any further pressure from Kvaerner. There may be a temptation to regard the costs we have incurred so far in defence of employment in the Clyde as 'sunk', so that any further demands from Kvaerner are measured as a marginal cost against the employment benefits of seeing the yard continue. I think that would be wrong: there is no end to the expenses down that path. My other concern is the position of the other BS yards, where interested parties may see the Govan deal as a signpost.

Govan was exceptional in that there was so much expectation of privatisation (which it seems to me was fuelled at least in part by the way in which BS was negotiating) that to hold out for better terms could have caused a furore out of all proportion to what was really at stake. This gave Kvaerner a strong hand.

Emotions will be no less high around the other yards, particularly NESL. I fully support the stand which you are taking against supporting further contracts for BS, which I know is not easy given the vigorous lobbying by which the BS Board is trying to undermine your position. But we must be equally wary of private sector interest in taking subsidised contracts there. No doubt you will keep me closely in touch with developments.

I am sending copies of this to the Prime Minister, Nigel Lawson, George Younger, Malcolm Rifkind and Tom King and to Sir Robin Butler.

J MAJOR



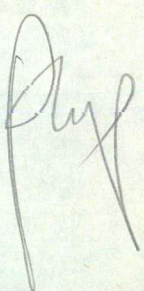
june.45

CONFIDENTIAL

FROM: A M WHITE  
DATE: 27 JUNE 1988

PS/CHIEF SECRETARY

cc PS/Chancellor  
Mr Anson  
Mr Monck  
Mr Phillips  
Miss Peirson  
Mrs Brown  
Mr Barton



**HARLAND AND WOLFF**

I received this afternoon, with no prior warning, the attached proposed question and answer on Harlands and Wolff.

2. I have told the Northern Irish, who envisaged the question being arranged for answer tomorrow, that there could be no question of such an answer being given until Mr King had consulted colleagues on the parameters of any such privatisation.

3. I would be grateful if you could reinforce that message by speaking to Mr King's office.

4. I gather that the reason why the question has been proposed stems from a discussion David Fell (Permanent Secretary, Department of Economic Development), and perhaps also Mr Viggers, had with Mr Tikkoo last Tuesday.

5. Mr Tikkoo, while expressing some interest in acquiring Harlands, was reluctant to commit himself to developing proposals if Northern Irish Ministers might then want to see if anyone else might come forward with a better deal. So he would want the intention to dispose of Harland announced before he entered serious negotiation, to flush out any potential competitors.

6. My objection to the proposed answer is that no proposition has been discussed at either official or Ministerial level to allow parameters to be set for a disposal of Harlands. The proposed answer would commit Mr King to negotiate without setting



any constraints. Not only that, we have not even been consulted on whether the Harlands costings for the Ultimate Dream are in any way realistic. Indeed I do not believe any detailed costings have yet been submitted to Mr King.

7. Coincidentally, I had already arranged for my visit to Belfast tomorrow to include a discussion on Harlands to bring me up to date with any developments! The agenda will obviously be more substantive than I was being led to believe as recently as this morning.

8. I will use the occasion to reinforce my telephone conversations of today with Mr King's officials, that such an answer is just not on, and to spell out the sort of ground they will need to cover in the urgent memorandum to colleagues that would need to precede any statement in opening negotiations to dispose of Harlands.

9. I attach, for information, the question and answer that Northern Irish officials had sought to clear with me. I would be grateful if you could confirm to Mr King's office that we are not prepared to see it issue tomorrow.



A M WHITE



MR. ALAN WHITE,  
TREASURY

QUESTION: To ask the Secretary of State for Northern Ireland if he will make a statement about the future of Harland and Wolff.

MR VIGGERS

In my response to the adjournment debate on 27 May I made it clear that were there to be an expression of interest in the privatisation of Harland and Wolff, the Government would take any such proposal very seriously. I can now announce that the Government has entered into negotiations with Tikkoo Cruise Line Limited about a possible acquisition of Harland and Wolff. These negotiations, which are at an early stage could lead to an arrangement under which the cruise liner, "Ultimate Dream" would be built under new private sector ownership.

The negotiations are not exclusive at this stage and the Government will be prepared to consider proposals from any other parties that might lead to privatisation of Harland and Wolff.





NORTHERN IRELAND OFFICE  
WHITEHALL  
LONDON SW1A 2AZ

SECRETARY OF STATE  
FOR  
NORTHERN IRELAND

The Rt Hon John Major MP  
Chief Secretary to the Treasury  
HM Treasury  
Great George Street  
LONDON  
SW1

CHIEF SECRETARY	
REC.	29 JUN 1988
ACTION	Miss Pearson
COPIES TO	EX Sir Peter Middle Mr Anson Mr Monck Mr Burgner Mr Moore Mr Turnbull Mrs Brown Mr AM White Mr Call.

29 June 1988

*Dear John,*

NEGOTIATIONS FOR SALE OF HARLAND & WOLFF TO MR RAVI TIKKOO

At the ad hoc meeting on 31 March colleagues indicated that they were content for negotiations to continue with Tikkoo, in particular about a possible transfer of the Yard to the private sector.

We hope shortly to receive sufficient information about the P3000 Project from H&W and Mr Tikkoo to enable us to make a decision as to whether or not to enter serious negotiations on privatisation. Mr Tikkoo has indicated his willingness to enter such negotiations positively. I for my part would go forward only if the initial assessment of the P3000 was favourable.

I would be anxious that you and colleagues should be aware of the parameters within which I would intend to authorise officials to embark on initial negotiations. In framing these parameters we are seeking to keep in line with the Kvaerner/Govan arrangements.



The parameters would be as follows:

- (a) The limit of our total involvement must be within what would otherwise be the cost of closure. This is estimated at £240m.
- (b) Phasing of the assistance would be such that public expenditure in any financial year would not exceed £60m. This is the amount included currently in the Northern Ireland baseline for H&W. The cost of support payments up to £60m per annum would be borne by the NI Block.
- (c) I would consider offering financial assistance to Mr Tikkoo to cover:
  - (i) any losses on existing orders;
  - (ii) unrecovered overheads in the period before reductions in the labour force take effect;
  - (iii) payments to those made redundant;
  - (iv) intervention subsidy on P3000, at a scale to be determined; and
  - (v) appropriate aid in respect of any new capital investment.
- (d) For orders after the P3000 Intervention support would be considered on its merits and in conformity with then current EC and UK policy (ie there would be no guarantee of 28% IF for future orders).
- (e) In addition, existing loans of £366m would have to be written off, but there was no realistic prospect of their repayment.

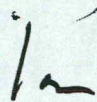


CONFIDENTIAL  
COMMERCIAL IN CONFIDENCE

Clearly if in the course of negotiations we wished to change any of these parameters I would return to discuss the matter with you.

Finally we face an Appropriation Debate tonight and an oral question on Thursday which is unlikely to be reached and will therefore be a written answer. I attach a copy of our draft reply which would also be the basis of briefing for John Stanley who will be handling the Appropriation Debate.

I am copying this letter to the Prime Minister, other E(A) colleagues and to Sir Robin Butler.

Z -  
TK 

CONFIDENTIAL  
COMMERCIAL IN CONFIDENCE

SMN3239



PARLIAMENTARY QUESTION FOR ORAL ANSWER ON THURSDAY 30 JUNE 1988

NO 2907

BY DR LEWIS MOONIE (L, KIRKCALDY)

To ask the SOS for Northern Ireland, if he has any plans to privatise shipbuilding operation at Harland and Wolff; and if he will make a statement.

DRAFT REPLY

The future of Harland & Wolff is now heavily dependent on whether the company, the Government, and Tikkoo Cruise Line Limited can come to agreement about terms on which the cruise liner P3000 could be economically built in Belfast. The Government has received the preliminary costings for this vessel and is now assessing these, and considering whether, and to what extent, it might provide contract support. That is the first priority. But, as I indicated in my response to the adjournment debate on 27 May, if there were to be an expression of interest in the privatisation of Harland & Wolff the Government would take any such proposal very seriously. Such an expression of interest has now come forward from Tikkoo Cruise Line Limited, and will be considered in the context of the Government's assessment of the P3000 project. We would wish to reach early decisions on this project and on the future arrangements for Harland & Wolff. In connection with the latter, the Government would be prepared to consider proposals from any other parties which might lead to the privatisation of the company.

SMN3239



3.29.6.

CONFIDENTIAL

FROM: MISS M E PEIRSON

DATE: 29 June 1988

CHIEF SECRETARY

cc PPS/Chancellor  
Sir Peter Middleton  
Mr Anson  
Mr Monck  
Mr Burgner  
Mr Moore  
Mr Turnbull  
Mrs M Brown  
Mr A M White o/r  
Mr Call

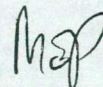
**HARLAND AND WOLFF**

Further to Mr White's submission of 27 June concerning a proposed PQ on Harland and Wolff, Mr King has now written to you about a PQ which has been put down for tomorrow and his wish to use his proposed line on that in a debate tonight.

2. Mr King also sets out the parameters within which he wants to authorise his officials to negotiate with Mr Tikkoo on privatisation. But it is not necessary to comment immediately: we shall be giving you further advice both on this, and also on the Ultimate Dream (when we get any information from Northern Ireland).

3. Meanwhile, I recommend that you agree to the terms of the PQ, as I have amended it (copy attached). The Northern Irish <sup>officials</sup> are quite content to accept the amendment, which I have made because nobody but the Department of Economic Development in Belfast has seen the "preliminary costings" referred to.

4. If you agree, perhaps your private office could inform Mr King's.



MISS M E PEIRSON



PARLIAMENTARY QUESTION FOR ORAL ANSWER ON THURSDAY 30 JUNE 1988

NO 2907

BY DR LEWIS MOONIE (L, KIRKCALDY)

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DRAFT REPLY

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SMN3239



CONFIDENTIAL



FROM: JILL RUTTER

DATE: 29 June 1988

MISS PEIRSON

cc:  
Principal Private Secretary  
Sir Peter Middleton  
Mr Anson  
Mr Monck  
Mr Burgner  
Mr Moore  
Mr Turnbull  
Mrs M Brown O.C.  
Mr A M White  
Mr Call

**HARLAND AND WOLFF**

I am afraid I could not get to you this evening to express to you the Chief Secretary's concern about the proposed line to take and draft PQ answer.

2 The Chief Secretary thought that the proposed PQ answer was far too forthcoming before he had seen any detailed analysis of the ~~PQ~~ proposals.

3 For tonight's appropriation debate I therefore told the Northern Ireland office that they must use a much blander formulation of simply saying that the Government was looking urgently at the matter. I would be grateful if you could attempt to produce a similarly bland PQ answer that the Northern Ireland Office could use tomorrow. There will be very considerable difficulties in clearing this with the Chief Secretary since he is very heavily committed tomorrow morning.

JILL RUTTER  
Private Secretary





NORTHERN IRELAND OFFICE  
WHITEHALL  
LONDON SW1A 2AZ

SECRETARY OF STATE  
FOR  
NORTHERN IRELAND

CH/EXCHEQUER	
REC.	30 JUN 1988 ✓ 30/6
ACTION	CST
COPIES TO	

The Rt Hon John Major MP  
Chief Secretary to the Treasury  
HM Treasury  
Great George Street  
LONDON  
SW1

29 June 1988

NEGOTIATIONS FOR SALE OF HARLAND & WOLFF TO MR RAVI TIKKOO

At the ad hoc meeting on 31 March colleagues indicated that they were content for negotiations to continue with Tikkoo, in particular about a possible transfer of the Yard to the private sector.

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The parameters would be as follows:

- X
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    - (ii) unrecovered overheads in the period before reductions in the labour force take effect;
    - (iii) payments to those made redundant;
    - (iv) intervention subsidy on P3000, at a scale to be determined; and
    - (v) appropriate aid in respect of any new capital investment.
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CONFIDENTIAL  
COMMERCIAL IN CONFIDENCE

Clearly if in the course of negotiations we wished to change any of these parameters I would return to discuss the matter with you.

Finally we face an Appropriation Debate tonight and an oral question on Thursday which is unlikely to be reached and will therefore be a written answer. I attach a copy of our draft reply which would also be the basis of briefing for John Stanley who will be handling the Appropriation Debate.

I am copying this letter to the Prime Minister, other E(A) colleagues and to Sir Robin Butler.

Z

TK

CONFIDENTIAL  
COMMERCIAL IN CONFIDENCE

SMN3239



PARLIAMENTARY QUESTION FOR ORAL ANSWER ON THURSDAY 30 JUNE 1988

NO 2907

BY DR LEWIS MOONIE (L, KIRKCALDY)

To ask the SOS for Northern Ireland, if he has any plans to privatise shipbuilding operation at Harland and Wolff; and if he will make a statement.

DRAFT REPLY

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SMN3239



CONFIDENTIAL

FROM: MISS M E PEIRSON

DATE: 30 June 1988

MISS RUTTER

cc Principal Private  
Secretary  
Sir Peter Middleton  
Mr Anson  
Mr Monck  
Mr Burgner  
Mr Moore  
Mr Turnbull  
Mrs M Brown o/r  
Mr A M White  
Mr Call

**HARLAND AND WOLFF**

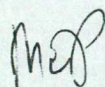
Thank you for your minute of yesterday; I am sorry you could not get me last night. I have provisionally agreed with DHSS officials the following draft reply, which I hope meets the Chief Secretary's concerns. Northern Ireland Ministers are not yet available, but could you get in touch with Mr King's private office (who have the draft), if possible before 1pm?

2. My redraft is as follows:-

"To ask the SOS for Northern Ireland, if he has any plans to privatise ship building operations at Harland and Wolff; and if he will make a statement.

Draft reply

An expression of interest in the acquisition of Harland and Wolff has come forward from Tikkoo Cruise Line Limited. The Government will consider it, and any proposals from any other parties which might lead to the privatisation of the company."



MISS M E PEIRSON





NORTHERN IRELAND OFFICE

WHITEHALL

LONDON SW1A 2AZ

<b>CH/EXCHEQUER</b>	
REC.	30 JUN 1988
ACTION	CST
COPIES TO	

30/6

Miss Jill Rutter  
Private Secretary  
HM Treasury  
Great George Street  
LONDON  
SW1

30 June 1988

Dear Jill,

**HARLAND AND WOLFF**

Following Mr King's letter of yesterday to the Chief Secretary, he has agreed to a redraft of a Parliamentary reply which will issue this afternoon in written form. I have already discussed the revise with you, Paul Grey and Peter Smith; and I now attach a copy for information.

I am copying this letter and enclosure to the Private Secretaries to the Prime Minister, other E(A) colleagues and to Trevor Woolley.

Yours sincerely,

David Watkins.

D J WATKINS

Enc



As I indicated in my response to the adjournment debate on 27 May, if there were to be an expression of interest in the acquisition of Harland & Wolff, the Government would take any such proposal very seriously.

An expression of interest in the acquisition of Harland & Wolff has now come forward from Tikkoo Cruise Line Limited. The Government will consider this and any proposals from any other parties which might lead to the privatisation of the company.





10 DOWNING STREET

LONDON SW1A 2AA

*Handwritten initials*

From the Private Secretary

CH/EXCHEQUER	
REC.	1-JUL 1988 ✓ 1/7 30 June 1988
ACTION	CST
COPIES TO	

Dear David,

NEGOTIATIONS FOR SALE OF HARLAND & WOLFF TO MR. RAVI TIKKOO

The Prime Minister has seen your Secretary of State's letter of 29 June to the Chief Secretary concerning the Harland & Wolff negotiations. The form of the parliamentary reply has been agreed following further discussions between private offices as recorded in your letter of 30 June to Jill Rutter. The Prime Minister has commented, however, that the parameters for the initial negotiations with Mr. Tikkoo involve a big decision which it would be unusual to take through correspondence. She would therefore be grateful if your Secretary of State could prepare a paper on this subject for consideration by E(A).

I am copying this letter to the Private Secretaries to members of E(A) and to Trevor Woolley (Cabinet Office).

*Handwritten in red ink:*  
 Is X really  
 true? If looks large  
 Extraneous  
 for me.

*Handwritten signature:*  
 Yes,  
 Paul

(PAUL GRAY)

David Watkins, Esq.,  
 Northern Ireland Office.



july.16

CONFIDENTIAL

FROM: A WHITE  
DATE: 4 JULY 1988

CHIEF SECRETARY

cc Chancellor  
FST  
Mr Anson  
Mr Phillips  
Mr Monck  
Miss Peirson  
Mr Barton  
Mr Call

*Granting to  
Crisis  
for  
A. L. S. J. S. M.  
1988*

**SHORT BROTHERS**

1. The Secretary of State has now received Mr Lund's review of the company's position and prospects.
2. That review considers three options:
  - a. disposal of the entire business to the private sector (estimated cost £454m);
  - b. disposal of missiles business and controlled rundown and closure of rest (estimated cost £549m);
  - c. pursuit of the company's development plans (estimated cost £377m).

Mr Lund concludes all feasible strategies would involve Government in a heavy cash outflow, but sees only c) as offering the possibility of receiving a return on that investment by eventual sale.

3. He asserts that his Board is not yet in a position to assess the chances of implementing c) successfully. He hopes that by the end of the year, or early 1989 a full appraisal of this option could be produced and indicates that he would wish to concentrate management effort on this work.

4. This is a most disappointing outcome in that the review has led Mr Lund to almost precisely the same conclusions as those the Secretary of State was not prepared to endorse when put forward as the basis of the company's 1987 corporate plan. The salient (and



unhelpful from Mr King's point of view) difference is that Mr Lund is pressing for a capital reconstruction of the company as at 31 March 1989. This he sees as requiring a £377 m cash input at 31 March 1989 to clear short term borrowings (£262 m) and provide working capital to underpin the development of the company.

5. He argues that this course would be less costly than either seeking to dispose of the business with its present problems or disposing of the missiles business only. He sees no prospect of reshaping the business to concentrate on missiles and aerostructures, arguing that an aircraft business is needed to provide a balanced entity.

#### The company's current position.

6. As you know, Short's performance last year, on which the Secretary of State has yet to report formally to colleagues, was extremely poor. The company's weak trading performance was compound by critical failings in its internal financial reporting and decision taking processes, leading to losses of £46m (pre-provision) and an EFL, financed mainly by short term bank borrowing, of about £120m.

7. Trading experience this year shows no sign of improvement, borrowing having risen to finance production costs by a further £62m, with sales very sluggish across the board. Northern Irish officials anticipate that even if sales now recover the EFR for the year will amount to £82m. Their previous forecast had been £46m.

#### Next steps

8. The Secretary of State, who had delayed seeking colleagues agreement to an EFL for the current year until Mr Lund's report was available, has now been asked to report to EA on 13 July on Short's among other Northern Ireland issues. His officials are yet to consult me on his draft paper, but have indicated that he is most concerned about both the present position and the



CONFIDENTIAL

difficult choices raised by the Lund review. I would not expect him to have reached a final view on the latter.

9. There is therefore a strong risk that once again he will argue that more time is needed before he can come forward with firm recommendations on the future of the company and that for the present the only decision that should be taken is to set an EFL for 1988/89. Such a decision by EA would leave Short's free to pursue into the autumn the applied Micawberism that has characterised their corporate planning for too long already, and which Mr Lund's appointment was supposed to end.

10. My view, which I have made clear to Northern Irish officials, is that the proper response to the Lund review is for Ministers to decide now in favour of a), with a presumption in favour of b) if a) proves unrealisable. As any sale of Short's in whole or in part is likely to take some time to negotiate the pursuit of this option should be accompanied by vigorous cash conservation measures, including halting further production of SD360 until the aircraft already built have been sold.

11. A more balanced estimate of the costs than Short's own view is needed, particularly for the disposal options. The Secretary of State should seek independent professional advice here, rather than that of the company itself, which is all Mr Lund offers. Independent work on the prospects of disposal should be set in hand immediately.

12. NO immediate decisions are needed in advance of Mr King's paper to EA. However it would be helpful in preparing briefing for that meeting to have your initial reaction to the position outlined above. In particular, do you agree that we should now press hard for early disposal?



A.M. WHITE



CONFIDENTIAL



FROM: J M G TAYLOR

DATE: 5 July 1988

A handwritten signature in black ink, appearing to be 'JMG'.

PS/CHIEF SECRETARY

cc PS/Financial Secretary  
Mr Anson  
Sir A Wilson  
Mr Phillips  
Mr Monck  
Miss Peirson  
Mr A M White  
Mr Barton  
Mr Call

**SHORT BROTHERS**

The Chancellor has seen Mr White's note of 4 July. He would be grateful for Sir A Wilson's considered views on this matter.

A handwritten signature in black ink, appearing to be 'JMG'.

J M G TAYLOR



july.16

**SECRET**

*pp3 207*

FROM: A WHITE  
DATE: 5 JULY 1988

CHIEF SECRETARY

cc **Chancellor**  
FST  
Mr Anson  
Sir A Wilson  
Mr Phillips  
Mr Monck  
Miss Peirson  
Mr Robson  
Mr Barton  
Mr Call

SHORT BROTHERS

Further to my minute of 4 July, I understand that the Secretary of State has now discussed the Lund review with his officials. He is not at all happy with Mr Lund's proposals, or with the way the company is being run.

He will be seeing Mr Lund tomorrow and clearly has management changes at the highest level in mind.

His paper to EA on Short's is likely to reject the Lund approach, seeking agreement rather to disposal of the missiles business, no further model development on the aircraft side, and retention if feasible of an aerostructures only business.

His proposals will be only partially costed, as the Lund report provides only a poor quarry for this approach. The costs will be substantial even on this route, given the very major short term debts to the banking sector Short's currently have.

I will report more fully when I have sight of Mr KING's draft EA paper.

*[Handwritten signature]*

A.M.WHITE

**SECRET**



000153

SECRET



FROM: JILL RUTTER

DATE: 5 July 1988

COPY NO 2 OF 13 COPIES

MR A M WHITE

cc:  
Chancellor  
Financial Secretary  
Mr Anson  
Sir A Wilson  
Mr Phillips  
Mr Monck  
Miss Peirson  
Mr Robson  
Mr Barton  
Mr Call

**SHORT BROTHERS**

The Chief Secretary has seen your minute of 4 July.

2 The Chief Secretary has commented on financial grounds that he agrees with pursuit of disposal of the entire business of the private sector not least because he expects Option C - pursuit of the company's development plans - would ultimately cost more. He thinks we should progress on this basis though he notes that wider Northern Ireland considerations will be evident at E(A).

3 His one question is whether we are likely to find a buyer for Shorts?

JILL RUTTER  
Private Secretary



bf. 12/7  
[Handwritten signature]



FROM: J M G TAYLOR

DATE: 5 July 1988

PS/CHIEF SECRETARY

cc Sir P Middleton

- Mr Anson
- Mr Monck
- Mr Burgner
- Mr Moore
- Miss Peirson
- Mr Turnbull
- Mrs M E Brown
- Mr A M White
- Mr Call

HARLAND AND WOLFF

The Chancellor has seen the recent correspondence on this. He has noted, with some surprise, Mr King's statement (his letter of 29 June) that the limit of our total involvement/the cost of closure is estimated at £240 million. He has commented that this looks extraordinarily large, and he would be grateful for confirmation that the figure is correct.

[Handwritten signature]

J M G TAYLOR



july.24

CONFIDENTIAL

FROM: A M WHITE  
DATE: 6 JULY 1988

PS/CHANCELLOR

cc PS/Chief Secretary  
Sir P Middleton  
Mr Anson  
Mr Monck  
Mr Burgner  
Mr Moore  
Miss Peirson  
Mrs M E Brown  
Mr Evans - DM  
Mr Guy  
Mr Call



**HARLAND AND WOLFF**

In your minute of 5 July to PS/Chief Secretary you asked for confirmation of whether the figure of £240m quoted by Mr King in his letter of 29 June was correct.

2. This estimate of the costs of closing Harlands after the completion of the yards last current order (AOROI for MOD) is a ball park figure produced by Mr King's officials.

3. They have not been able to consult the company on it and have derived it from Harlands 1987 Corporate Plan and their knowledge of subsequent developments in the yard. I have asked them to provide an annex to Mr King's memorandum to EA setting out the details of their calculations.

4. As I understand it, the main components of the figure are:-

	£m
Trading support to 1991-92	114
Redundancy costs	88
Terminal bonuses	20
Other closure costs (demolition etc)	<u>18</u>
	240



The costs appear consistent with those Mr King included for this option in his memorandum for the Prime Minister's meeting of 19 November, when he made clear that he was unwilling to contemplate any more precipitate closure scenarios.

5. He is however seeking to establish this figure not as provision to be made against closure costs, but as the negotiating "envelope" within which he will attempt to secure a Govan - style disposal of the yard to Mr Tikkoo or failing that to one of the other parties who have apparently expressed some interest in the yard.

6. The figure, derived as it is, is inevitably imprecise but in my view is more likely to be an underestimate than an overestimate of the costs of such a protracted run down and closure. (For example it assures that very recent productivity gains are maintained throughout the run down of the yard.)

7. It is also worth noting that Mr King has indicated that providing the costs of a Govan - type disposal do not exceed £60m a year, he will meet them from within his existing block provision. So he has a clear incentive not to concede too high a price in negotiation.

8. Consequently I believe it to be a reasonable figure for Mr King to use in preparing his EA paper, although in briefing for EA I will advise that, should Ministers accept that it should be established as a formal 'envelope' for negotiations on the disposal of Harlands, they should do so only subject to detailed examination of its calculation by officials.



A M WHITE





Ch.

You may like a word  
with CST about whether you or  
he should lead on this

(and on Harland + Wolff,  
behind) at E(A). — next  
Wednesday

W

(rest of agenda is likely  
to be Macrie on which  
you will presumably lead,  
and lignite power station  
on which CST will lead)



july.25

SECRET

FROM: A M WHITE  
DATE: 6 JULY 1988

CHIEF SECRETARY

cc Chancellor  
Financial Secretary  
Sir A Wilson  
Mr Phillips  
Mr Monck  
Miss Peirson  
Mr Robson  
Mr Richardson  
Mr Barton  
Mr Call

### SHORT BROTHERS

Mr Kings paper to EA will signal a radical shift in his position to now favour early disposal of this company to the private sector in whole or in part.

2. He has today met with Mr Lund and told him that he is not persuaded by the Lund report. He is not prepared to accept that the risky FJX proposal for a new collaborative aircraft should be pursued any further. If no private sector purchaser is interested in acquiring Short's aircraft business it should be run down and closed.

3. He is not convinced by the company's argument that an aerostructures business cannot be viable without aircraft manufacture, but if their view proves correct that business too would be closed.

4. He believes that at least the missiles business is likely to be saleable (Ferranti have already expressed an interest in acquiring Short's, their real interest being the missiles side) and will wish to make his intention of disposing of Shorts more widely known to flush out other potential purchasers.

5. However, he has no confidence in the ability of Short's management to contain the present difficulties, still less ready the business for disposal. He envisages substantial resignations

SECRET



or terminations of appointment up to and including board level and is looking for a very senior figure to take effective control of the business to push it in the direction he wishes it to go.

6. As you know, he is deeply disappointed that the existing non-executive directors, the company's auditors and his professional advisors on the company's position and prospects failed to detect the deterioration in the company's position that is now all too clearly apparent.

7. He is very concerned that, following last years poor trading performance and discovery of the failure of Short's internal financial monitoring and control systems which compounded its financial effect, the company remains in a weak trading position, sinking yet further into debt with the private sector on the back of his guarantee of their borrowing. He is most anxious to apply a financial tourniquet and to have a management in place that will carry out the necessary reforms.

8. The costs in public expenditure terms of disposing of Shorts will be considerable. The Lund report estimated the financial cost of clearing Short's mainly short term bank debts and restructuring the balance sheet as at 31 March 1989 as £314m. Earlier action as Mr King clearly envisages and drastic cash conservation measures may reduce that somewhat but not I suspect very significantly. There will clearly also be substantial redundancy costs which could amount to some £90m if only the missiles business were to survive, although not all these costs would fall this year.

9. The missiles business might command a price of some £70m, and a controlled run down of the aircraft business might yield something further in terms of the sale of completed aircraft and parts to service existing Shorts aircraft. Completion of the Tucano contract, if that proved feasible, would result in some further receipts. If a separate aerostructures business survives then that too might fetch a modest price. But it seems likely that very substantial costs, for which Mr King neither has nor could reasonably find provision, will need to be faced with the



main burden in the current year. My preliminary estimate, of which I have advised Mr Richardson, is that this might amount to a claim on the Reserve of some £350m in 1988-89.

10. As Mr King develops his proposals - and it is clear he will not have a fully rounded set of proposals to put to EA - I shall of course refine that assessment.

11. Although the major redundancies now in immediate prospect will add to Mr King's problems in Belfast (where they will fall almost exclusively on the East Belfast protestant population) the course which he is now prepared to take, costly though it is, is likely to prove less costly and more economically sound than the alternative previously pursued of trying to sustain Shorts with its present product range and capabilities.

12. I will brief more fully when Mr King has circulated his proposals to EA.



A M WHITE



3/2919

CONFIDENTIAL

FROM: A J MACASKILL

DATE: 7 July 1988

MR BARTON

cc

Sir A Wilson ✓  
Mr A White  
Ms Seammen  
Mrs Brown  
Mr Cory/  
Mr Harding (oa)  
Mr Swan (or)

**SHORT BROTHERS - LUND REPORT**

The Lund Report recommends Strategy C (Develop the FJX aircraft to replace the SD360 and privatise the business) as it offers the Government a prospect of recouping the necessary investment, and therefore is the cheapest net cash cost. Unfortunately it is also the option with the highest risks attached to it.

2. In 1987 De Havilland notified Shorts that they no longer wished to pursue the development of the NRA90B, a 25 seat aircraft, but were happy for Shorts to find another partner to replace them. As no partner was found Shorts have now put forward an alternative plane, the 44 seat FJX. (The size of plane is surprising given that Shorts and De Havilland considered the sector above 30 seats to be over-subscribed.) Shorts' inability to find a partner in their preferred market highlights one of the risks involved in Strategy C as it is possible that none of the potential partners referred to in the review will wish to proceed with the FJX. If this happens Shorts will be in the same position at March 1989 as they have been for the last four years, desperately in need of a new aircraft to replace the SD360, and keep the company alive.

3. The FJX project is considered to provide a pre-tax return



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of 15% assuming 50% launch aid and a market share of some 30%. This is a marginal return given the market share required and is therefore unlikely to attract many manufacturers. Launch aid would not be available to overseas partners, which could make the project even less desirable to potential collaborators.

4. To properly assess the cost to Government of Strategy C it will be necessary to obtain greater details of the assumptions made in respect of launch aid. It is difficult to determine the extent of launch aid included in the report as there are various inconsistencies and ambiguities, eg p73 refers to Shorts having a 25% share of the project, entitled to 58% of the sales price and accountable for £78m (on which 50% launch aid is assumed) of the £400m project development costs.

5. DTI Ministers have indicated in the past that they were unsympathetic to the principle of launch aid. If Strategy C were to be adopted we would need to clarify whether the FJX project could go ahead without launch aid or accept that a further cash injection was needed if DTI failed to grant aid.

6. Strategy C is a high risk strategy in that all hopes rest on the success of FJX. Shorts Aircraft Division of the 90s would be dependent on essentially one product needing a 30% share in a highly competitive market. Failure to achieve the desired volume would no doubt result in the need for the development of another plane in a different sector and a further injection of funds from the Government.

7. Strategy A (disposal of the business to the private sector) offers the most attractive option despite the costs included. The major drawback with A is that potential buyers will be hard to find.

8. There is unlikely to be many purchasers around who would share the current management's belief that the company could become profitable if it continued in its present shape and



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developed FJX. And I doubt if a management buy-out is a possibility. Even if we were to inject £80m more than is required to adopt strategy C it is unlikely a new owner would accept the risks associated with development and marketing the FJX.

9. Accordingly Strategy A and Strategy B (closure of aircraft and aerostructure and sale of missile division) effectively are the same, the difference being whether the public or private sector is at the helm when closure is necessary. This is based on the assumption that the buyer of Shorts would only be interested in the Missile Division and would be prepared to purchase the whole company to get this division, provided of course closure costs of the other operations were fully funded by the Public Sector.

10. The Report states that the Aerostructures division could not be viable if aircraft manufacture ceased. This is based on the view that design technology could not be held to the same standard without aircraft manufacture, and accordingly sufficient business for this division to be viable could not be achieved. Possibly the design argument is overplayed, but the nature of the aerostructure industry is extremely volatile and likely to end up being a drain on resources if continued as a separate business. However, I think Shorts need to provide us greater evidence of the dependency of aerostructures on aircraft before we dismiss the option.

Summary

11. Shorts has one attractive division which should be easy to sell to the private sector, the Missile business. Even if funds were injected into the business to cover closure costs it is unlikely that a buyer would prefer to use these funds to develop the business, in view of the risks involved in launching a new aircraft. Accordingly the private sector



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is likely to purchase the business only as a means of buying the missile division. Sale of the business to the private sector is likely to result in closure of aircraft and aerostructures. However, new owners may find an alternative to that strategy, therefore it is better to allow the private sector to take the final decision on closure.

*A Macaskill*

A J MACASKILL





FROM: B ST QUINTON  
DATE: 8 JULY 1988

1. MR MCGIVERN *AG 8/7* ✓  
2. FINANCIAL SECRETARY

TRANSPORT COMMITTEE - REPORT ON THE DECLINE IN THE  
UK-REGISTERED MERCHANT FLEET

1. The Department of Transport have been in touch with us about the Government's response to the Transport Committee's report on the decline in the UK-registered merchant fleet. Four of the Committee's recommendations are about taxation policy. Transport propose to submit a memorandum commenting on each of the Committee's recommendations under cover of a letter from the Secretary of State for Transport and have asked for contributions on the taxation points.

2. Transport believe it would be helpful to respond as quickly as possible as there will probably be little new to say and they do not want to raise expectations of a more substantial response. They have therefore asked for our contributions by 11 July. The final version will be cleared with Treasury Ministers by the Secretary of State for Transport towards the end of July.

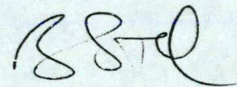
cc Chancellor  
Chief Secretary  
Paymaster General  
Economic Secretary  
Sir P Middleton  
Mr Scholar  
Mrs Case  
Mr Revolta  
Miss Sinclair  
Mr A R Williams  
Mr Cropper  
Mr Tyrie  
Mr Call

Mr Isaac  
Mr Painter  
Mr Lewis  
Mr Keith  
Mr Reed  
Mr R H Allen  
Mr Fraser  
Mr Jarvis  
Ms St Quinton  
Mr K Allen  
PS/IR



3. Mr Fraser's note of 21 June on "New Clause: Taxation of Seafarers" set out the Committee's main recommendations which affected us and our early comments on them. We have now worked up some fairly short responses - on lines which Ministers have already agreed in earlier papers - and these are attached, together with a copy of the report's conclusion and summary of recommendations.

4. Are you content for these contributions to be sent to the Department of Transport?



B ST QUINTON



## VIII CONCLUSION AND SUMMARY OF RECOMMENDATIONS

161. At the start of this inquiry we noted that central to it must be the question of whether the UK needs a merchant fleet and, if so, whether the UK Government should provide support for the shipping industry beyond that which it provides for other industries. We believe that the case for a merchant fleet both on strategic and on economic grounds is unarguable. Perhaps the only difficulty lies in convincing the Government that it should give tangible recognition to that fact. In evidence, the Parliamentary Under-Secretary of State, the Lord Brabazon, said several times that if the decline continued, the Government would have to take further measures. We believe the time for action has arrived and that the Government must now take steps to ensure that a core fleet, of a size sufficient to fulfil its strategic and economic roles, is maintained.

162. We asked also whether support should be provided for the shipping industry, beyond that provided for other industries. In our view, the support provided for shipping does not match, much less exceed, that given to other industries<sup>1</sup>. The UK shipping industry operates in a highly competitive international market where the greater proportion of its competitors enjoy tax and other concessions. It is in line fiscally with the rest of UK industry though an element of free depreciation remains. It is not eligible for Enterprise Zone tax benefits, etc, and does not share the same import barriers that are available to much of UK industry and agriculture. We believe therefore that there is a case for the Government to provide assistance to enable the UK shipping industry to compete more fairly with that of the rest of the world. We do accept however that unilateral UK action alone may be insufficient. Whatever improvements in training, financial incentives, new manning agreements or even protectionist policies such as restricted cabotage may be pursued, there will always remain the risk that other countries may take further measures to undercut the policies adopted by the UK Government. As some such foreign action could well affect safety, international action and agreement will clearly be necessary and Her Majesty's Government would be well advised to consider what steps it could take towards such an end in the EEC and outside, if further efforts to help British shipping, such as those contained in this report, are not to be frustrated. The UK needs a merchant fleet. We hope that our recommendations will help to ensure its continued existence.

163. Our main recommendations are as follows:

- i That the Department of Transport institute random checks of surveys carried out and that, if the surveys carried out by any particular Classification Society are shown to be seriously inadequate, the Department ensure that no further surveys are delegated to that Society (para 71).
- ii That urgent and sympathetic consideration be given to the proposals for roll-over relief for balancing charges (para 121).
- iii That the Business Expansion Scheme limit of £5 million be raised substantially (para 122).
- iv That the Government does not hesitate to use the power it has taken to introduce a test of establishment for operators who wish to carry out cabotage in UK coastal waters if the discussions in the EC on the abolition of cabotage are not brought to a satisfactory conclusion within a reasonable period of time (para 124).
- v That the Government should look again at the whole question of employers' National Insurance contributions in respect of foreign-going seafarers (para 136).
- vi That the present practice with regard to deduction of tax from seafarers employed by ship management companies should continue (para 143).
- vii That urgent consideration be given to amending the statutory regulations which prevent Inland Revenue from deducting tax from an employee where an employer should have operated PAYE (para 143).
- viii That the sum made available by the Government for training be doubled (para 148).

1. See, e.g., Appendices 10 and 11



participate with the clear aim of improving the image and stressing the opportunities of the UK shipping industry (para 149).

- x That the arrangements for repatriating UK-owned vessels registered in foreign countries be concluded as a matter of the highest priority (para 153).
- xi That, if the Merchant Navy Reserve is not effective, the Government give consideration to further measures (para 158).
- xii That periodic training of the Reserve be introduced (para 159).



## ROLL-OVER RELIEF FOR BALANCING CHARGES

- 163(ii) The Select Committee recommend that urgent and sympathetic consideration be given to the GCBS proposals for roll-over relief for balancing charges). A balancing charge represents the withdrawal of tax relief given for depreciation that has not occurred; and it is important that, where necessary, such a charge is made if capital allowances are to fulfil their objective of allowing relief for actual depreciation of business assets. The roll-over of a balancing charge arising on the sale of a ship by deduction from future capital expenditure on a new or secondhand vessel, provided the replacement is acquired within three years of the disposal, would go beyond that objective. It would also run counter to the general thrust of the Government's 1984 reform of business taxation, with its emphasis on removing from the system distortions which result from special reliefs of the kind proposed and at the same time reducing rates of tax. Moreover, the Government is not convinced that the proposals would have a significant effect in halting or reversing the decline of the fleet (which continued to contract during the decade up to 1985 when special tax incentives were available).



BUSINESS EXPANSION SCHEME LIMIT OF £5 MILLION

163(iii) The Committee recommend that the Business Expansion Scheme limit of £5 million be raised substantially. The annual limit for raising finance which qualifies for Business Expansion Scheme relief is £500,000 for most businesses, but it was recognised that this would be inappropriate for shipping (and for companies letting residential property on the new-style assured tenancy terms). The higher limit recognises the fact that current market conditions may make it difficult for shipping companies to raise even quite large amounts of equity finance. When setting the limit the Government had regard to the aim of the relief which is to help small unquoted companies start up and expand. £5 million was thought about right. Only one shipping company has made significant use of BES and, on each of two occasions, it raised about £5 million. However, we shall keep the limit under review. We hope the Committee welcomes the extension of the higher limit to companies which operate their own ships as well as it applying to those which let them on charter.



We have taken recommendations vi and vii together because they are linked.

163(vi) The Committee recommend that the present  
and (vii) practice with regard to the deduction of tax from seafarers employed by ship management companies should continue and if so that urgent consideration be given to amending the relevant statutory regulations to enable the Revenue to collect the tax from employees in the shipping industry where the employer should have operated PAYE. Where a person has a statutory obligation to operate PAYE, the Inland Revenue has a duty to try to ensure that that obligation is fulfilled. It has no discretion in this matter. So, the Inland Revenue having concluded that, in general, ship management companies should be operating PAYE, it has no option but to inform the companies concerned with a view to getting PAYE operated as soon as possible. That process has already been set in train; and in the circumstances the question of amending the PAYE Regulations does not arise.

The Committee reported (para 142) that they would understand if the Inland Revenue decided to make the deduction of PAYE the responsibility of the shipping company. In those circumstances they felt that special arrangements should be made to avoid the seafarer having to reclaim tax that he has overpaid. Some seafarers qualify for a special tax relief, available to people who work overseas, known as the foreign earnings deduction which means they do not pay tax on their overseas earnings. To qualify for this relief, their work pattern must be such that there is a continuous period of absence abroad of at least 365 days. But within this period specific allowance is made



for some visits home. In this year's Finance Bill the Government has relaxed in the case of seafarers the rules governing the length of permitted home visits. From 6 April 1988 many more seafarers are expected to qualify for this very generous tax relief which should ease the operating cost pressures which have been leading some companies to move their ship overseas and to employ foreign crews.

It is never possible to establish with certainty entitlement to this relief until after the event. But the Inland Revenue has offered to explore with the industry whether, for some seafarers at least, crewing arrangements are now sufficiently long-term and certain, for it to be reasonable for them to authorise relief, on a provisional basis, in advance. Where this can be done, seafarers will, as the Committee suggests, be paid gross so that they do not have to reclaim tax overpaid at the end of the year.



july.28

SECRET AND  
IN CONFIDENCE

BF 1217  
FOR MEETING FOLDER

FROM: A M WHITE  
DATE: 11 JULY 1988

CHANCELLOR

cc Chief Secretary  
Financial Secretary  
Mr Anson  
Mr Monck  
Miss Peirson  
Mr Barton  
Mr Call

**E(A)(88)34: JAMES MACKIE AND SONS LIMITED**

The Secretary of State seeks no decisions. His paper simply informs colleagues that, following his discussions with you of 19 May (record of meeting attached), he is making efforts to involve the private sector on the basis of a reverse auction.

2. He says that the company's position continues to be precarious (information from the Liverpool agent of the Bank of England tends to confirm this) and that while he has extended his existing £2m guarantee until the end of August, there are doubts as to whether the company would be able to trade beyond that date, even if the guarantee is further extended.

3. The paper reiterates his view that Mackies must be assisted and describes the £20m package of assistance (£7.5m conventional selective assistance, £12.5m convertible loan stock) that Mr King failed to persuade you to support when you met on 19 May. It seems most probable that, should efforts in the next few weeks fail to identify a private sector interest prepared to acquire Mackies on a 'dowry' basis, Mr King will revert to that proposal.

4. There is a division of view at official level as to whether that package of assistance would be notifiable to the Commission. I hope to get that point resolved at EQ(0) tomorrow and will provide a supplementary note.

SECRET AND COMMERCIAL  
IN CONFIDENCE

*Not done  
arrived - 11/7  
p. 10*



Comment

5. There is no doubt that James Mackie is in a very fragile state. If the company is to be sustained, as the Secretary of State believes it must on political and social grounds given its importance as West Belfast's leading manufacturing employer, a solution must be reached shortly. An indication of how difficult the company's position now is, which has come to light since Mr King wrote his paper, is that it may be necessary for him to increase his guarantee from £2m to £2½m to enable the company to borrow enough money to cover its holiday pay bill next month. (Mackies directors have advised IDB of this possibility - should it materialise, Mr King would seek to agree the increase of £½m with the Chief Secretary.) So Mr King has genuine cause to believe that a solution to the form of assistance to be offered to Mackies cannot be long delayed.

6. It is therefore to be hoped that his efforts to develop a private sector led solution will be successful. If not, he is likely to revert before much longer to his earlier difficult proposal for a package of grant and loan assistance.

Recommendation

7. You should take note of the Secretary of State's paper and indicate your strong preference for a private sector led solution to the company's difficulties.



A M WHITE



EC-CST, FST, AMG

WEST, Sir P Mirrington

Mr Anson, Mr Phillips

Mr Mason, Miss Pearson

Mr Burgess, Mr Walker

Mr Attridge, Mr Starett

Mr McCull



M. A. M. think  
Why should we require any  
guarantees or penalties of a  
buyer? If we do, aren't we  
effectively keeping machines in  
public control?

Treasury Chambers, Parliament Street, SW1P 3AG

01-270 3000

Mr. H. H. H.  
To hear Mrs Pearson's  
point in mind NW 26/5

Martin Donnelly Esq  
Private Secretary  
Secretary of State for Northern Ireland  
Whitehall  
LONDON SW1A 2AZ

19 May 1988

Dear Martin,

JAMES MACKIE

Your Secretary of State and the Chancellor this afternoon discussed the next steps on James Mackie.

Your Secretary of State said that negotiations now seemed to have reached an impasse, as it was clear to all concerned that a rescue on the terms preferred by E(A) - a secured loan with a floating charge on the company's assets - was not feasible. There seemed to be agreement that your Secretary of State's revised proposal represented the least unsatisfactory way forward of the remaining alternatives, but the Treasury did not accept that a rescue on these terms was consistent with the E(A) remit.

Your Secretary of State set out his reasons for believing that we had to proceed on the revised proposal. Finding the money was not a problem: he would accommodate it within his block, and was not registering a bid. He likened Mackie's position to that faced by Rolls Royce in 1971 - short-term difficulties so severe that no-one in the private sector would come forward with a solution, but, in the long term, secure markets and good prospects if the storm could be weathered. He would envisage returning the firm to the private sector in a few years, and said that the professional advice he had taken supported this view.

The decisive factor, however, was the political background in West Belfast. Mackie's was a major employer, drawing from both communities, in an area with 50 per cent male unemployment. The shaky financial position of the company was not perceived by the work force, who would only see that the company was not short of orders. If Mackie were to go to the wall, there would be very awkward parallels with Shorts, where the Government would be seen to have written off £40 million in one year, albeit unwittingly and

19/20/5





retrospectively, for an East Belfast company with a mainly Protestant work force.

As far as the E(A) remit was concerned, your Secretary of State said that he agreed that the Treasury had won the economic argument: it had been accepted that there was absolutely no case for a rescue, on purely economic grounds. However, he felt that the meeting had also given some weight to the particular social and political problems that arose because it was a Northern Ireland company. They had wanted the Treasury to co-operate in finding the "least worst" solution, and ideally, they would have wanted this to take the form of a secured loan. However, this simply could not be done, because of legal problems, and because the Northern Bank had got there first. So your Secretary of State now felt he had to proceed on the basis of his revised proposal. If this could not be sorted out bilaterally with the Treasury, then he would have to return to E(A).

He emphasised the priority he attached to this issue, and that he thought it trickier than either Shorts or Harland and Wolff. At Shorts there would be a difficult time ahead, and there would be redundancies, but he thought the business could eventually get back on track. For Harland and Wolff, he envisaged either a private sector solution, or that the company would simply have to fold. But the situation in West Belfast was particularly sensitive: there was a helpful mood in the community at the moment, and he was not prepared to jeopardise it by allowing Mackie's to go to the wall. If the Chancellor felt able to put to one side his reservations about a rescue on terms other than a secured loan, your Secretary of State said he would value Treasury help in the further work to refine the "least worst" solution.

In reply, the Chancellor said that he agreed that the question was not how we would treat a company in this position anywhere else in the UK: we did have to consider all the circumstances. These included the position which had developed at Shorts, which the Chancellor said he found very disturbing. He was very concerned to learn that the Finance Director at the time was still involved in managing the company. However, he agreed that Shorts might well become a viable business, although in his view the aircraft side of the business might have to go. On Harland and Wolff, he understood that the Secretary of State had for a long time taken the view that closure was the only option. Your Secretary of State said that the priority must clearly be to finish the existing orders. Apart from that, there was the question of Mr Tikoo, and other possible private sector buyers. There was attraction in calling their bluff, indicating the kind of dowry that was available, and giving them a deadline by which they had to respond.

Turning to Mackie itself, the Chancellor said he did not entirely see the parallel with Rolls Royce in 1971. The sums of money at stake in Rolls Royce had been larger, and it was therefore not at





all surprising that the private sector had not come forward with a solution. Also, the Rolls Royce problem had emerged with much less warning, and there had been less time to look around for alternative more acceptable solutions. However, there had been plenty of time to find a private sector rescuer for Mackie, if the firm really was viable, but no-one had expressed interest. This did raise the question of whether the company had a future, or would be forever dependent on public support. Your Secretary of State repeated his view that the problem was a short-term one. Once the necessary modernisation programme had been effected, and the management team strengthened, it should be viable. The Chancellor said that if it really was a short term problem, then this might be another case for offering a dowry if a reputable firm were prepared to take the company on. This would meet the Chancellor's particular concern that to proceed as earlier proposed by Mr King, i.e. without a secured loan, would effectively renege on the assurances we had given the PAC after deLorean. Thought would still need to be given to the practicalities of a "dowry" solution, and to the guarantees that we would require of the buyer. The Chancellor said that he would envisage the company been put out to a sort of reverse tender - with the lowest dowry bidder winning. The key points of the existing corporate plan could be written into the contract, with clawback penalties if the buyer did not conform to the conditions of the plan.

It was agreed that, compared with the earlier revised proposal, this was an attractive option and the practicalities should be considered urgently by officials.

I am copying this letter to Jeremy Heywood in the Financial Secretary's Office.

Yours,

Moir.

MOIRA WALLACE  
Private Secretary