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PART TWO Confidential Filing

A320 – EUROPEAN AIRBUS.

AEROSPACE

Pt 1 March 1982
Pt 2 March 1986

Referred to	Date	Referred to	Date	Referred to	Date	Referred to	Date
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PART 2 ends:-

DTI to COP. 30.11.87

PART 3 begins:-

DTI to COP. 3.12.87.

LaPC

PM/87/054

CDP
29/9

PRIME MINISTER

EC/US: Airbus

1. In his minute of 24 September Kenneth Clarke sets out the current position in the Airbus dispute with the United States very clearly. My officials have been working closely with his on this problem. As Kenneth says in his minute, the French and Germans are still not taking this issue sufficiently seriously and I very much hope that he will be able to use the Ministerial meeting in Munich on 29 September to press them as he proposes. We shall take other opportunities as they arise with these Governments to reinforce the point.

2. Meanwhile we are also emphasising to the Americans the serious consequences of US action against Airbus. We have made this point a number of times at official level and I repeated it to George Shultz when I saw him in New York last week.

3. We have heard from the Commission in Brussels that, according to US officials, Boeing and McDonnell Douglas may be intending to take early trade action against Airbus. The Embassy in Washington consider that this is indeed a possibility, but the US Ambassador to

the EC claims that the Administration are actively trying to restrain the companies from taking a decision that would have very serious implications. Tom King will be briefed to counsel restraint when he visits Boeing on 29/30 September.

4. I am copying this minute to Kenneth Clarke, George Younger, Paul Channon and Sir Robert Armstrong.

(GEOFFREY HOWE)

Foreign and Commonwealth Office

29 September 1987

Aerospace: Airbus Plc

ccPC

Tg 02972

CDP on.

MR POWELL, (10 Downing Street)

CDP
25/9.

EC/US AIRBUS

WITH CDP?

The Chancellor of the Duchy of Lancaster has minuted the Prime Minister on 24 September about the stage in the delicate negotiations between the United States and the Community on government support for Airbus. This is yet another of the issues between the United States and the Community at the present time and one of the most delicate. Though our share in the Airbus programme is not as big as that of France and Germany we have been taking the initiative with the Commission in trying to ensure that the Airbus partner governments do consider the issues temperately and realistically. Possibly the best hope that agreement may be reached with the United States is the extent of inter-locking between the American and European air frame and engine industries. It is because of this that in paragraph 4 of his minute the Chancellor of the Duchy concludes that it would be difficult to devise trade measures against the Americans which do not cause more damage to British than American interests. But by the same token the Americans also have major interests in selling planes to European airlines and buying engines for US-produced planes.

At this stage the Prime Minister need do no more than take note.

J H HOLROYD

25 September 1987

CONFIDENTIAL

cc: PC

TO:

PRIME MINISTER

Prime Minister 2
for information.
DCW
25/9.

FROM:

KENNETH CLARKE

24 September 1987

EC/US: AIRBUS

1 You will be aware that the UK and the other Airbus partner Governments (France, Germany and Spain) are involved in a dispute with the US over alleged subsidies to the Airbus Industrie consortium (AI). I have now met my fellow Airbus Ministers and held talks with Commissioner de Clercq. In view of the potential seriousness of the situation if the US were to initiate trade action against AI, and the possible speed with which this could happen, I thought you should know the latest position.

SE3ADH

2 Briefly, the US Government, under pressure from Boeing and McDonnell Douglas, AI's competitors, has alleged that the increasing success of Airbus has been detrimental to the US airframe manufacturers and that this success has been unfairly won through substantial Government subsidies. The Airbus partner Governments have argued strongly that US companies receive a great deal of indirect financial support from their Government through NASA and the Department of Defense. In an effort to end the dispute, however, the partner Governments and the EC Commission (which has joint competence in this area) have offered to sign a "Draft Agreed Minute" if the US were to renounce its right to take unilateral trade action against Airbus under its own legislation.

3 Not surprisingly, the US are pressing for the proposed Minute to require a reduction in the level of any future Government launch aid support and the provision of more information about any such support. I have made clear to the other Airbus Ministers and to Mr de Clercq that I would be prepared to go quite a long way towards meeting these points. In my opinion, they should not pose much difficulty to the

British Government. I very much hope that we shall not receive further applications for launch aid. If we do, I shall be looking at the very least to reduce the proportion of total cost and to tighten the conditions still more. I am also quite content for the terms of our providing launch aid to be more transparent. Much of the information which the US are seeking, other than that of a commercially confidential nature, is readily available from the reports we currently make to Parliament.

4 However, the French and Germans are much more reluctant and belligerent. The problem is being handled by Ministers who sponsor the industry and do not want to commit themselves to the reduction of subsidy or the disclosure of it. The French are also prepared to contemplate trade measures against the Americans of an unspecified kind in the aircraft field. It would be extremely difficult to devise such measures which do not cause more damage to British than American interests, particularly to Rolls-Royce and British Airways. A "Trade war" would also threaten the whole market position of Airbus in the US and would very seriously damage the whole Airbus programme.

SE3ADH

5 The French and Germans also take a more optimistic view of the likelihood of the US not initiating any trade action. Our Washington Embassy's assessment is that the US Government and Boeing will not take any decision in advance of a meeting between the US Trade Representative, Mr Yeutter, and Mr de Clercq and Airbus Ministers at the end of October. They describe McDonnell Douglas as very restive, however, although because of their current talks with AI on possible collaboration on new aircraft programmes their deadline for a decision on trade action now appears to have slipped well into October. Their hopes of military sales and collaborative ventures in Europe may also be a restraining influence. It seems likely, however, that if the meeting with Mr Yeutter goes badly, the dangers of an escalation will increase rapidly.

6 I am pleased to say that Mr de Clercq largely shares my assessment. He agrees with me that the risk of US action is a serious one and he shared my doubts that the Airbus partner Governments could take effective countervailing action against the US. We agreed that it was essential to have careful Ministerial preparation on the Airbus side well in advance of the meeting with Mr Yeutter. My line will be to continue to emphasise to my Airbus Ministerial colleagues the potential

seriousness of the situation and to press them to take a more flexible approach. The next opportunity will be when I see them at a meeting in Munich on 29 September. I shall inform you of any important developments.

7 I am copying this minute to Geoffrey Howe, George Younger and Paul Channon, and to Sir Robert Armstrong.

KENNETH CLARKE

SE3ADH

(Mr. Greenway), does my right hon. Friend agree that children also have rights as well as teachers and that children have been badly affected by the industrial action that has occurred in our schools in the past few months? That time will never be made up. Will she pay tribute to the good teachers who have refused to obey the dictates of their union bosses?

The Prime Minister: I gladly pay tribute to all those most excellent teachers who regard their first duty as towards the education of their pupils. Parents throughout the country are very grateful to those teachers. The new pay arrangements are designed to give those teachers greater promotion and greater incomes than others.

Mr. Ron Lewis: Will the Prime Minister tell us whether she read an article which appeared in her favourite newspaper, the *Daily Mail,* a few weeks ago under the heading, "Who takes the prize for champion liar . . .?" Since that publication, it would appear that President Reagan and his team are well ahead in the race. When the Prime Minister goes on television——

Mr. Speaker: Order. It is a well-known rule that we do not make accusations by attribution. I hope that the hon. Gentleman is not trying to do that.

Mr. Lewis: I have made no accusations, I am quoting from the newspaper.

Mr. Speaker: But that is accusations by attribution.

Mr. Lewis: I do not intend to make any accusations against anyone. When the Prime Minister goes on television during the election, will she confirm to the British public that never at any time in the past seven years has she ever told a single lie?

The Prime Minister: I hope that the hon. Gentleman has looked at the replies that I have given from the Dispatch Box and found them accurate to the very level best of my ability.

Mr. Speaker (Members' Farewells)

Mr. Speaker: I have a brief statement to make. In view of what was said on Tuesday about hon. Members desiring to have an opportunity to bid me farewell, which I much appreciated, I wish to inform the House that I will be in the Chair at the close of business tomorrow to shake the hands of hon. Members, especially those who are not standing for re-election.

I shall be at home in Speaker's House on Monday next between 12 and 1 pm. I would welcome the opportunity, on that occasion, to offer refreshment and good wishes for the future to hon. Members who are retiring—and I say to the hon. Member for Warley, East (Mr. Faulds) that no one will be turned away.

Mr. Andrew Faulds (Warley, East): On a point of order, Mr. Speaker.

Mr. Speaker: I shall take it after the statement.

Mr. Faulds *rose*——

Mr. Speaker: Order. I will take points of order in their usual place. Nothing arises on my statement.

Later——

Mr. Faulds: On a point of order, Mr. Speaker. This is more in the mature of an RSVP than a point of order, and I am sure that you will allow me to make it. It was extraordinarily kind of you to issue such a privileged invitation to me for these small drinks—*[Interruption.]* — perhaps large drinks — on Monday. I shall be responding to you privately about that, with great gratitude for your extraordinary and unique invitation.

However, on the question of the cancellation of the prorogation, do you not agree, as I am sure that my colleagues on both sides of the House would agree, that it would be more fitting if in future the wishes of this House and its Speaker were considered rather than the lazy inclinations of the other place and its chairman?

Mr. Dennis Skinner (Bolsover): I should be careful about giving my hon. Friend open invitations to your place, Mr. Speaker. You never know, he might just sus it out for the future.

On the question of the prorogation——

Mr. Nicholas Winterton (Macclesfield): Dissolution.

Mr. Skinner: Yes, dissolution. May we have it stated openly, before anyone else puts his foot in it, that the ceremony was stopped in 1979? It did not happen in 1983, and the lack of it is not something new for 1987.

Mr. Speaker: It is not for me to express an opinion. Indeed, the hon. Member for Bolsover (Mr. Skinner) once wisely advised me not to do so. However, such ceremonies have good historical reasons and act as a reminder of many of the past struggles of those who have been before us in this place. It would be a matter of regret if we were to let them go.

Airbus A330/A340 Projects

3.33 pm

The Secretary of State for Trade and Industry and President of the Board of Trade (Mr. Paul Channon): With permission, Mr. Speaker, I would like to make a statement about the Government's policy on the question of launch aid for British Aerospace's participation in the airbus A330/A340 projects.

After discussion with British Aerospace, I am glad to tell the House that agreement has been reached that up to £450 million in launch aid will be provided to enable the company to participate in the airbus A330 and A340 projects. This launch aid will be fully repayable on terms designed to yield an acceptable return in real terms on the Government's investment. At this stage our support is conditional upon our partner Governments also making the arrangements that are necessary to enable their manufacturers to participate in the projects.

At a time when the competitive pressures in the world aerospace industry are as strong as ever, I would like to praise the determination of Airbus Insustrie and its partners to extend their family of large airliners.

Mr. Terry Davis (Birmingham, Hodge Hill): Will the Secretary of State take it from me that the Labour party is wholeheartedly in support of British Aerospace and the airbus programme and that our attitude towards his statement is that it is better late than never? Will he confirm that, whereas the package amounts to £450 million, British Aerospace told the Government that it needed £750 million. and therefore it follows that the Government are helping British Aerospace to the extent of less than two thirds of what it needs?

Will the Secretary of State also confirm that the French and German Governments are to provide more than two thirds of the development costs incurred by their aerospace industries in connection with the airbus programme? Will he admit that, when the money runs out, it will be almost inevitable that thousands of men and women who work for British Aerospace will follow their Westland colleagues into unemployment?

Mr. Channon: I am extremely surprised at the hon. Gentleman's grudging support for the announcement. He said that it is better late than never. I do not know how he can describe it as late. We are the first Government to announce a desire to give launch aid for participation in the project. Frankly, the idea that it is late is ridiculous.

The French and Germans have not offered any money so far, so it would be most unwise of me to speculate about how much they will offer for the costs of the project. I am sure that the project will be a great success. British Aerospace and the Government have been holding constructive talks for some time. Both the company and the Government are satisfied that what I announced today will enable their essential objectives to be achieved. My announcement will help to create and maintain about 10,000 jobs. I should have thought that the House would have welcomed it.

Mr. Alan Haselhurst (Saffron Waldon): My right hon. Friend's statement will be widely welcomed in British civil aviation. It is an extremely important boost to British Aerospace in general, which has been making an ever-greater contribution to Britain's trade balance. Will he confirm that the Government are committed to the group of aircraft that are proving to be world beaters?

Mr. Channon: I agree with what my hon. Friend said about the group of aircraft and also the achievements of British Aerospace and the aerospace industry in general. After all, last year, aerospace industry exports reached nearly £5 billion, which was 12 per cent. up on the figure for 1985. There were orders of some £8 billion, 60 per cent. of which were from overseas. The industry is one of Britain's greatest national assets, and the Government are determined to support it.

Mr. Stephen Ross (Isle of Wight): I congratulate the Government on the announcement. It is welcome on the Opposition Benches, even if it took the imminence of a general election to bring it forward, with perhaps rather more money than was previously forecast. May I take it that the money is adequate for British Aerospace to participate fully in its 20 per cent. stake in the airbus project?

Mr. Channon: It is a little unfair of the hon. Gentleman to say that the imminence of the general election brought about the announcement. We had to make the announcement by 11 June because of the Paris air show, which begins on that date. *[Interruption.]* I expect that other announcements may be made. British Aerospace is convinced that it will be able to participate fully. I am certain that it would not have agreed to participate in such a way if it had not been so convinced.

Sir Anthony Kershaw (Stroud): Is my right hon. Friend aware that many of my constituents, trade union officials and others in the Stroud area will be gratified by the news? I also speak on behalf of the constituents of my right hon. Friend the Member for Northavon (Mr. Cope) who, because of his position, cannot easily speak about those who work at Filton.

Mr. Channon: It is good news for Filton and all those who work there, and it is also good news for British Aerospace in general.

Mr. Bruce Millan (Glasgow, Govan): Will the Secretary of State say whether there is any provision in the agreement that he reached with British Aerospace for the use of the Rolls-Royce V2500 Superfan as and when that engine becomes available for the A340?

Mr. Channon: We will have to await Rolls-Royce proceeding with that and putting forward proposals for this engine to go into that programme. It would be premature to give the right hon. Gentleman an answer at present.

Mr. John Wilkinson (Ruislip-Northwood): My right hon. Friend's announcement is welcome. Does he agree that, far from foot-dragging, our Government are proving to be a catalyst to more effective European aerospace collaboration in securing a whole family of European airbuses that can compete fairly and squarely with Boeing and McDonnell Douglas in the world market? Is not the investment cost-effective, particularly when one considers the repayment terms which will be required from Her Majesty's Treasury?

Mr. Channon: Yes; it is a good investment. I think it is cost-effective and is a very good example of European collaboration. It will be good for the industry, for British Aerospace, and for the taxpayer.

Mr. George Park (Coventry, North-East): Will the Secretary of State accept that his announcement, although welcome, may have the effect of creating difficulties for other projects which British Aerospace is funding without aid?

Mr. Channon: I do not see why that should be so. If British Aerospace had not wanted to participate in this project, it would not have agreed with the Government on this announcement. The Government and British Aerospace are in full agreement on the announcement. Therefore, I cannot agree with the hon. Gentleman. If he has in mind a special point, perhaps he will get in touch with me.

Mr. Kenneth Warren (Hastings and Rye): I welcome my right hon. Friend's announcement. Can he please tell the House what obligation he has put on British Aerospace to support the rest of the British aerospace industry in the orders and sub-contracts which it will place? In particular, why is there no support for the British equipment industry in this project?

Mr. Channon: I know that my hon. Friend takes a deep interest in the whole industry and in the equipment suppliers. Of course, they are eligible to apply under various schemes and we will consider all cases on their merits. Obviously we have not had any applications yet. On the A320, the British equipment suppliers got a good share of the business. I hope that that will be the case in this project also.

Mr. James Lamond (Oldham, Central and Royton): May I also welcome the announcement by the Secretary of State on behalf of hundreds of constituents and thousands of members of the trade union which sponsors me in Parliament who were fearful of joining their colleagues on the dole queue if the announcement had not been made?

Can the Secretary of State confirm that this is a loan which will have to be repaid because the project is likely to make a great deal of money? Also, in restricting the amount that he is prepared to give to £450 million, does not he agree that other projects being considered by British Aerospace must be in jeopardy because, despite the fact that it has accepted the proposal made by the Minister, it will have to go to the market to find the remaining £300 million?

Mr. Channon: Launch aid is repayable. It is not a grant; it is not a subsidy. The intention is that the principal sum advanced should be repaid in full, together with an adequate return during the life of the programme.

I cannot agree with the hon. Gentleman on the other part of his question. The Government and British Aerospace are satisfied that the launch aid that I have announced today will enable the central objectives of the company to be achieved. It is clearly necessary to safeguard the interests of taxpayers, and British Aerospace properly wishes to safeguard the interests of its shareholders. Both sides are satisfied. I see no reason to complain about the proposal.

Sir Patrick Wall (Beverley): I congratulate my right hon. Friend whose announcement will have a good effect in my constituency. Is it not £100 million more than was in question when the original negotiations took place? Can my right hon. Friend confirm that it is wholly for the airbus project and not for any other project such as HOTOL?

Mr. Channon: This is launch aid entirely for the A330 and A340 projects. I do not want to go into all the details of the negotiations with British Aerospace, but I think that it is well known that there have been talks on different sums at different times. Both sides are satisfied with this announcement. I am glad that my hon. Friend has spoken about this because I know of the great concern in his constituency which I was happy to visit a little while ago when I had discussions about this very matter.

Mr. Jack Straw (Blackburn): Since many of us, on behalf of constituents working in British Aerospace factories, including those at Salmesbury, Preston and Wharton in Lancashire, have been in correspondence seeking pledges from the Government over many months for launch aid, is it not the case that both the amount of the aid and the timing of the announcement have been dictated by the anxieties of Conservatives in marginal seats? The Minister says that this money is to be repaid with a rate of return. Is it not a sad reflection on the City that British Aerospace is unable to obtain long-term investment funds for this project save from the British Government?

Mr. Channon: I do not think that that is true at all. Very large sums in funding have been committed to the project by British Aerospace itself. The characteristics of civil aircraft programmes are long development and payback periods, and the level of risk exposure means that the close involvement of Governments is a factor in many countries. It is appropriate for an element of Government support to be given. This is in no way to suggest that the City's support should be criticised. The amount is agreed with British Aerospace, so I cannot understand why any hon. Member should wish to disagree on that point.

I have made an early announcement because I thought that that was in the interests of the company and those who work in it and also because I expect that a firm decision will have to be taken by other Governments during the course of the next few weeks; and, frankly, I thought that the House of Commons had a right to be informed.

Sir Peter Emery (Honiton): On the matter of competition, will my right hon. Friend confirm that as long as the French and the German Governments make contributions in line with the contribution of the British Government and he can give an assurance that there should be major success with these two aircraft this should be published not only to the House of Commons but also to those companies that originally placed provisional orders for these aircraft in order that the necessary assurance can be given to them to overcome the approaches of Boeing and McDonnell Douglas, which obviously would like to see the provisional orders removed from these aircraft going to the American companies? It is most important that something should be done on these lines.

Mr. Channon: I agree with my hon. Friend. I am very hopeful that our partners in France, Germany and Spain will also wish to participate in this programme. Indeed, I

[Mr. Channon]

am certain that they will. I believe that substantial sales can be achieved. It is extremely significant and encouraging that there are commitments from nine airlines for the A330 and the A340 totalling 128 aircraft and that these have been obtained in advance of a formal commitment to launch the programme. The House will also be aware that there are orders and options for the A320 numbering 442 with almost a year to go before that aircraft enters commercial service.

Mr. David Young (Bolton, South-East): Will the Minister please assure the House that he will keep under review financial support for British firms in the civil avaiation industry so that in all ways, commercially and industrially, we back these firms and enable them to maintain the leadership which they have now established in the industry?

Mr. Channon: I think that our actions speak louder than words. We have indeed supported this industry. I agree with the hon. Member about its great importance; the British aerospace industry is now the second largest in the world. It is one of our most flourishing industries and I am looking forward to supporting it still more in the next Parliament.

Mr. Michael McNair-Wilson (Newbury): I welcome my right hon. Friend's statement, which seems to me to underline our commitment to the concept of a European civil aircraft industry and therefore is keeping faith with our European partners. Can he give any estimate of the additional work which may be generated for British industry from these two projects?

Mr. Channon: I am grateful to my hon. Friend. I agree with him about the signal that this will give to the European civil aviation industry in general.

I think that this will maintain or create some 10,000 jobs in the aerospace industry in this country. It will provide very substantial job opportunities and a very substantial amount of work. I hope that it will provide a substantial amount of work for equipment suppliers and, indeed, for many other suppliers further down the line who will have the spin-off from that. It is a very big project and will provide a great deal of work.

Mr. Bowen Wells (Hertford and Stortford): I congratulate my right hon. Friend on making this announcement. Will he confirm that this will keep the British aerospace industry at the leading edge of technology and therefore lead to further orders outside this narrow, although very large, order in relation to Airbus Industrie? Will he point out to the House and Britain as a whole that this demonstrates the Government's continuing support for manufacturing industry in this county and gives the lie to the Opposition statements that we are constantly running down manufacturing industry?

Mr. Channon: I agree with my hon. Friend's last point. The view that he describes is sheer nonsense. As the whole House knows, it is very encouraging to see that the growth in productivity in our manufacturing industry is now outstripping that in the rest of the world. It is also encouraging to see how well British Aerospace has done since it was privatised. Its profit figures and its record of orders from abroad are excellent. The House should be proud of that, and all hon. Members on both sides of the House who have worked closely with British Aerospace know of the great success of that firm. It is winning many other orders overseas, and will take part in many other projects apart from the A330 and A340 projects.

Mr. Dennis Skinner (Bolsover): Whatever happened to monetarism? For the past three and a half years, just as in the previous general election campaign, the Government have been telling us that throwing money at companies in both the private and the public sectors will not create jobs. Yet for the past six months leading up to the announcement of the election Ministers have been scrambling to get to the Dispatch Box to tell us about the grants, loans, subsidies and so forth that have been allocated to provide jobs. If they can provide jobs during the six months before an election, why cannot the Government be honest enough to tell us that they will do it throughout? Is it true that they are going to call this Airbus Election '87?

Mr. Channon: The hon. Gentleman does not really want a lecture on monetarism from me, and the House would be pretty bored if I attempted to give one. I believe that there is a general desire in all quarters of the House — and that includes the hon. Gentleman — that we should support this imaginative scheme. It will be very good for British aviation, and for Britain in general.

We have taken an extremely short time to make up our minds. We have done it more quickly than any of the other partner Governments, whom, in the words of the Leader of the Opposition, he no doubt considers slothful. We are determined to take part in the scheme, and the hon. Member for Bolsover (Mr. Skinner) cannot say that we are throwing away money as the taxpayer will receive an acceptable rate of return in real terms.

Mr. Michael Stern (Bristol, North-West): Will my right hon. Friend accept the thanks of the many people who work for British Aerospace at Filton, in my constituency, for today's announcement? Does he agree that in building on the success of the A320, as he has done this afternoon, he is showing that we as a Government support success rather than wishing, as the Opposition spokesman, the hon. Member for Birmingham, Hodge Hill (Mr. Davis), appears to have done this afternoon, that he had come to the Dispatch Box and announced failure?

Mr. Channon: I agree entirely. We believe in backing success. This company has been very successful, and we are pleased to be able, after careful evaluation, to offer launch aid for the programme. It is extremely good news for Filton. I am sure that I am not alone in paying tribute to the excellent work done there, and I hope that there is a good future for that base of British Aerospace.

Mr. Nicholas Winterton (Macclesfield): On behalf of hundreds of my constituents who work for British Aerospace at Woodford, I thank my right hon. Friend and the Government for the statement. As he has said, British Aerospace has been outstandingly successful since its privatisation, not only in guaranteeing secure jobs but in its return on capital invested. Will he emphasise that, if we are to continue to play a meaningful part in providing civil aviation aircraft, it is vital that British Aerospace should be part of any wide-bodied project so that it can compete with McDonnell Douglas and Boeing?

Will my right hon. Friend also give an assurance that if, in the light of subsequent events, the French and the

Germans are seen to be giving additional launch aid, he will be prepared to consider a further approach from the management of British Aerospace for further aid? As my right hon. Friend highlighted in his statement, such aid will be repaid in accordance with the production of the A330 and the A340 as and when they are produced and sold.

Mr. Channon: I am most grateful to my hon. Friend for his support. I know of the work that is done at Woodford and of the great importance of that work to British Aerospace.

I agree about the importance of the civil aviation industry in this country and in Europe. This afternoon's announcement will enable British Aerospace to join the Germans, the French and the Spanish in European collaboration to provide these aeroplanes. It will lead to a very exciting future for European civil aviation, going wider than United Kingdom civil aviation alone, although that must be our particular concern.

As for French and German launch aid, I do not think that I should anticipate what the German and French Governments may announce, because I have no idea what that announcement may be. Therefore, I had better stick to what I have already said—that this is good news.

Mr. Gerald Howarth (Cannock and Burntwood): Is my right hon. Friend aware that this decision will be widely welcomed not only in constituencies such as that of my hon. but silent Friend the Member for Kingswood (Mr. Hayward), which has a British Aerospace manufacturing facility, but also in Cannock and Burntwood, where we take an objective view of these matters? Does my right hon. Friend agree that this historic decision represents a decisive strike at Boeing's long-held monopoly in the long-haul market?

Mr. Channon: I am very grateful to my hon. Friend. I assure him that the silence of our hon. Friend does not mean that he has not been an active pursuer of this decision. I pay tribute to many of my hon. Friends, who have been very persuasive and who have explained to me very clearly and coherently why this is such an important project. I am also very glad to have the support of my hon. Friend the Member for Cannock and Burntwood (Mr. Howarth) for this very exciting project, which will be very good for the future of the aviation industry.

Mr. Keith Raffan (Delyn): I thank my right hon. Friend for the statement, which will be widely welcomed by those who work at British Aerospace, Broughton, where the wings for the A330 and A340 will be built, but is he able to provide more details about launch aid? Is he able to give the time span over which the money will be made available? Will it be front-end loaded? Does he agree that these two planes can be at least as commercially viable as the A320, which had more firm advance orders than any other civil aircraft in the history of mankind?

Mr. Channon: My hon. Friend recently came with a deputation to see me about the matter, and I pay tribute to him for his continuing interest in the project. There is every prospect of these aircraft being commercially viable. If I did not believe that, the Government would not have offered launch aid. I hope that my hon. Friend will forgive me if I do not go into the details of the launch aid, which must remain commercially confidential. However, it would not be going too far to say that there is a considerable element of front-end loading that will be helpful to British Aerospace.

Mr. Speaker: Mr. Geoffrey Dickens.

Mr. Geoffrey Dickens (Littleborough and Saddleworth): They also serve, Mr. Speaker, who stand and wait.

General elections always bring out the worst in everybody. Despite some of the remarks that have been made about this statement, on behalf of the thousands of people who work for British Aerospace, whether on the shop floor or in the board room and of whatever political party, may I thank my right hon. Friend most sincerely for this vote of confidence and support in them, including hundreds of my constituents in Littleborough and Saddleworth? I hope that it will be duly recorded that it was due to my representations that they got the money.

Mr. Channon: I am very grateful to my hon. Friend. During the lifetime of this Parliament I have made it an absolute rule to do everything that my hon. Friend asks me to do.

Mr. Speaker: May I say to the hon. Member for Littleborough and Saddleworth (Mr. Dickens) that very frequently those who stand have to wait!

Appellate Committee (Proceedings)

Mr. Speaker: I undertook to reply today to the point of order raised yesterday by the hon. Member for Tiverton (Mr. Maxwell-Hyslop) about the making available to hon. Members of this House and to the public of the proceedings of the Appellate Committee of the House of Lords. In the time available, I have been able to make only a preliminary appreciation of the problems involved, but I have already concluded that the matter raised by the hon. Gentleman touches upon the rights of the House of Lords to determine which parts of its proceedings to print or publish. I undertake to draw the attention of the authorities of the House of Lords to the hon. Gentleman's point and to supply them with a copy of the arguments that he advanced in its support.

Mr. Robin Maxwell-Hyslop (Tiverton): I am grateful to you, Mr. Speaker, for your response. However, with the delicacy and tact perennially at your command in these matters, might you not also draw to the attention of the authorities in another place the fact that their expenses are met from the Consolidated Fund by a Vote of this House and that their Members subsist thanks to that Vote? Therefore, if they wish to stand on the fine point of expenditure, that may call into question an examination of their whole expenditure before this House votes it—perhaps something that neither they nor some of us would wish to bring about.

BILL PRESENTED

VEHICLE NUMBER PLATES

Mr. Fallon presented a Bill to regulate the manufacture and supply of vehicle number plates; and for connected purposes; And the same was read the First time; and ordered to be read a Second time tomorrow and to be printed. [Bill 163.]

BUSINESS OF THE HOUSE

Ordered,

That, in respect of the Irish Sailors and Soldiers Land Trust Bill *[Lords]*, if the Bill be committed to a Committee of the whole House, further proceedings on the Bill shall stand postponed and that as soon as the proceedings on any Ways and Means Resolution come to by the House in relation to the Bill have been concluded, this House will immediately resolve itself into a Committee on the Bill.—*[Mr. Durant.]*

SITTINGS OF THE HOUSE

Resolved,

That this House shall not adjourn to-morrow until Mr. Speaker shall have reported the Royal Assent to any Acts which have been agreed upon by both Houses. — *[Mr. Durant.]*

Orders of the Day

Criminal Justice Bill

Lords amendments considered.

Clause 1

THE SERIOUS FRAUD OFFICE

Lords amendment: No. 1, in page 2, line 15, after "him" insert "on reasonable grounds"

4.2 pm

The Minister of State, Home Office (Mr. David Mellor): I beg to move, That this House doth agree with the Lords in the said amendment.

Mr. Speaker: With this it will be convenient to take Lords amendments Nos. 2 to 4 and 172.

Mr. Mellor: The Bill comes back to us in a somewhat different form from that in which it left us, as I am sure that those of us who sat through 36 sittings of the Committee will ruefully have to concede. I am glad that the other place was prepared to consider, in the time available, the very important provisions of part I, dealing with serious fraud, which have always commanded the support of all parties in the House. We properly had lively debates in both Chambers and in Committee about the precise nature of, and the demarcation lines appropriate to, the powers, duties and responsibilities of the Serious Fraud Office.

Clearly, a number of significant provisions in the Bill will not now become law during the lifetime of this Parliament; for example, the important changes to the laws of extradition and the arrangements for child witnesses to give evidence by video link as well as other significant changes to the laws of evidence, changes in penalties and important improvements in the law on confiscation. I hope and expect that those provisions will come back at an early stage of the new Parliament. I trust that they will then be considered with the seriousness of purpose and in the spirit of co-operation that characterised our debates in Committee.

The amendments mainly serve to make explicit assumptions that we believe to be implicit. Amendment No. 1 makes it clear, for example, that the director of the Serious Fraud Office may involve himself in a case only on reasonable grounds. Under amendments Nos. 2 and 3 the admissibility of prior inconsistent statements in the court when the defendant chooses to give evidence is placed beyond doubt. In the other place Lord Roskill called forcefully for the deletion of clause 2(8) on the ground that the financial and companies legislation on which the serious Fraud Office powers are modelled expressly allow evidence obtained by the investigative powers to be adduced in court against those who provided the information.

We undertook to reflect further on that matter, and naturally gave great weight to the fact that the point was made to us by Lord Roskill, who, with others, had been charged with the duty of considering the matter and bringing forward the report upon which the present changes are based. Nevertheless, we concluded that the traditional safeguards in criminal proceedings should

010.

CC G

DEPARTMENT OF TRADE AND INDUSTRY
1-19 VICTORIA STREET
LONDON SW1H 0ET
TELEPHONE DIRECT LINE 01-215 5422
SWITCHBOARD 01-215 7877

PS/

Secretary of State for Trade and Industry

14 May 1987

David Norgrove Esq
Private Secretary to the
Prime Minister
10 Downing Street
London SW1A 2AA

Dear David

LAUNCH AID FOR BRITISH AEROSPACE

Following Cabinet this morning, I attach the text of the statement on Launch Aid for British Aerospace which my Secretary of State proposes to make this afternoon.

I am copying this letter to Mike Eland (Lord President's Office), Robert Culshaw (FCO), Alex Allen (Treasury), Andrew Lansley (Chancellor of the Duchy), Steven Wood (Lord Privy Seal's Office), Max Felstead (Chief Secretary's Office), Murdo MacLean (Chief Whip's Office) and Trevor Woolley (Cabinet Office).

Yours

Timothy

TIMOTHY WALKER
Private Secretary

JG4AYG

With permission, Mr Speaker, I would like to make a statement about the Government's policy on the question of launch aid for British Aerospace's participation in the Airbus A330/A340 projects.

After discussion with British Aerospace, I am glad to tell the House that agreement has been reached that up to £450m in launch aid will be provided to enable the company to participate in the Airbus A330 and 340 projects.

This launch aid will be fully repayable on terms designed to yield an acceptable return in real terms on the Government's investment.

At this stage our support is conditional upon our partner Governments also making the arrangements that are necessary to enable their manufacturers to participate in the projects.

At a time when the competitive pressures in the world aerospace industry are as strong as ever, I would like to praise the determination of Airbus Industrie and its partners to extend their family of large airliners.

DW3CCA

V8e

file

bc: BG

10 DOWNING STREET

LONDON SW1A 2AA

From the Private Secretary

14 May 1987

Dear Tim,

LAUNCH AID FOR BRITISH AEROSPACE

The Prime Minister has seen the draft statement about Launch Aid attached to your letter to me of 13 May. She has suggested amending the third paragraph to read:

> "...re-payable on terms designed to yield an acceptable return in real terms from the Government's investment."

Without the word "acceptable" the sentence could imply that the expected return may be tiny in real terms.

The Prime Minister also questioned whether it was right to say there would be a return in real terms: there may well be a loss once funding costs are taken into account. This point was, however, discussed in Cabinet today and the Prime Minister accepts the need for a phrase of this kind.

The Prime Minister is otherwise content, subject to the views of colleagues.

I am copying this letter to Robert Culshaw (Foreign and Commonwealth Office), Alex Allan (Treasury), Andrew Lansley (Office of the Chancellor of the Duchy of Lancaster) and Trevor Woolley (Cabinet Office).

Yours,

David.

David Norgrove

Tim Walker, Esq.,
Department of Trade and Industry.

cc BG

DEPARTMENT OF TRADE AND INDUSTRY
1-19 VICTORIA STREET
LONDON SW1H 0ET
TELEPHONE DIRECT LINE 01-215 5422
SWITCHBOARD 01-215 7877

PS/ *Secretary of State for Trade and Industry*

13 May 1987

David Norgrove Esq
Private Secretary to the
Prime Minister
10 Downing Street
London SW1A 2AA

Prime Minister

BAe have agreed to pay royalties on a sliding scale up to 910 aircraft. If all 910 were sold the rate of return to the taxpayer would increase from 7% to about 8%.

Content with the statement, as amended? (An alternative would be to say "worthwhile.")

DRN 13/5.

Dear David

LAUNCH AID FOR BRITISH AEROSPACE

As I mentioned to you over the telephone, we have now reached an agreement with British Aerospace on the one point outstanding from this morning's meeting. I now attach a first draft of the statement that my Secretary of State proposes to make, subject of course to approval by colleagues in Cabinet tomorrow.

I am copying this letter to Robert Culshaw (FCO), Alex Allen (Treasury), Andrew Lansley (Chancellor of the Duchy) and Trevor Woolley (Cabinet Office).

Yours

Timothy

TIMOTHY WALKER
Private Secretary

JG3BBJ

With permission, Mr Speaker, I would like to make a statement about the Government's policy on the question of launch aid for British Aerospace's participation in the Airbus A330/A340 projects.

After discussion with British Aerospace, I am glad to tell the House that agreement has been reached that up to £450m in launch aid will be provided to enable the company to participate in the Airbus A330 and 340 projects.

? We make a loss

This launch aid will be fully repayable on terms designed to yield ~~a~~ an acceptable return in real terms on the Government's investment.

At this stage our support is conditional upon our partner Governments also making the arrangements that are necessary to enable their manufacturers to participate in the projects.

At a time when the competitive pressures in the world aerospace industry are as strong as ever, I would like to praise the determination of Airbus Industrie and its partners to extend their family of large airliners.

Following the great success of the A320 this should be seen as a further vote of confidence in the British aerospace industry as a whole and in the technical skills of its workforce

DW3CCA

A087/1355

PRIME MINISTER

Airbus

The Secretary of State for Trade & Industry will seek the Cabinet's approval under "Home Affairs" for the proposal to provide British Aerospace (BAe) with launch aid for the Airbus A330 and A340 projects. He proposes to make an oral statement to Parliament tomorrow afternoon.

2. A Group of Ministers under your chairmanship agreed earlier today that the Government should offer launch aid of £450 million (53.5% of the launch aid costs compared with the 54% given on the A320) on condition:-

(a) it is fully front loaded;

(b) the Government's target rate of return is 7% in money terms (as with the A320);

(c) the Government's return is through fixed sterling levies on sales of more than 610 aircraft on a sliding scale, the first 125 being levy free.

3. Since, however, the 7% rate of return implies a borrowing cost subsidy by the Government, you asked the Trade and Industry Secretary to press BAe to accept some further formula that would give the government a share in any "super profits" on sales above the expected 610.

4. I understand that Mr Channon will report that he has succeeded in negotiating the following further arrangements. The Government will receive £300,000 per aircraft on the next 100 aircraft sold above 610; £600,000 on the second 100 above that

figure; and £900,000 on the third 100. If these totals were reached, the Government's return would be raised to 8%.

5. I understand that Treasury Ministers, though hoping for more, are likely to accept this. If Cabinet are also content, you will want to authorise Mr Channon to make an appropriate statement subject to clearance of its terms with the Chief Secretary, Treasury and the other Ministers most directly concerned.

RA

Robert Armstrong

Cabinet Office
13 May 1987

CONFIDENTIAL - COMMERCIAL IN CONFIDENCE

SUBJECT

CC MASTER

10 DOWNING STREET

LONDON SW1A 2AA

13 May 1987

From the Private Secretary

Dear Tim,

AIRBUS

The Prime Minister this morning held a meeting to discuss launch aid for the prospective Airbus A330/340 projects, on the basis of your Secretary of State's minute of 1 May, and subsequent correspondence. There were present your Secretary of State, the Lord President, the Foreign Secretary, the Chancellor of the Exchequer, the Chancellor of the Duchy of Lancaster, the Chief Secretary, Mr Unwin (Cabinet Office) and Mr George Guise (No.10 Policy Unit).

Your Secretary of State said that Sir Austin Pearce believed he could secure the agreement of the BAe board to launch aid of £450m., provided this was front end loaded, that there was a target rate of return of 7 per cent and that levies only began after sales of 125 aircraft. The calculations assumed sales of 610 aircraft, which DTI believed would very likely be achieved. The French Government would wish to announce its launch aid at the Paris Air Show which would begin on 11 June. The German Cabinet would be meeting on 3 June, and would come under great pressure from the French to come to a conclusion. The other possible deals described in his minute centring on launch aid of either £420m or £500m were not in his view as attractive as launch aid of £450m., with its related terms and conditions. It was most unlikely that the Government would be able to achieve an improvement on this deal.

The Chief Secretary agreed that the £450m. package was preferable to the others. There were however weaknesses in it. The front end loading would exacerbate the difficulties for public expenditure during the PES period. The National Audit Office had criticised the rate of return expected from expenditure on launch aid for the A320 and the Government should seek for the A330/A340 either to win agreement to levies on the first 125 sales or to secure royalties on sales above 610. The latter would be preferable. Your Secretary of State would need to be satisfied about the provision for recourse in the event of failure by BAe. And finally the provision for monitoring should be improved. The Chancellor of the Exchequer reported Stoltenberg to be adamant that no decision should be taken by the German

Government on 3 June. The German Finance Ministry faced a number of public expenditure bids - including one for space spending - and Stoltenberg wished these to be considered together. This could not take place before the end of June at the earliest. It was possible however that Stoltenberg's view would not prevail.

After further discussion, it was agreed that the Government could not expect to achieve a major improvement on a launch aid offer of £450m. with its associated terms and conditions. To delay an announcement until after the election would risk damage to the prospects for the A330/A340 projects and could also be politically damaging. It would however be entirely reasonable and right for the Government to seek to secure royalties on sales above 610 aircraft. The Prime Minister invited your Secretary of with State the Chief Secretary and the No.10 Policy Unit to decide a proposal to be put to the company today. This proposal should not demand too much; it should be reasonable under all the circumstances. DTI negotiators could point to the criticism made by the National Audit Office of the rate of return on the A320, and say that they would expect Cabinet to agree to the package, provided the royalties were agreed. They should negotiate toughly. But it would be wrong to make royalties on sales beyond 610 aircraft a break point in the negotiations. Your Secretary of State should make an oral report to Cabinet tomorrow and should aim to make an oral statement to the House tomorrow afternoon. A draft of the statement should be circulated to No.10 and the Treasury. It would be important for the Government and BAe to co-ordinate their positions on the announcement.

I am copying this letter to Tony Kuczys (HM Treasury), Jill Rutter (Chief Secretary's Office) and Trevor Woolley (Cabinet Office).

David Norgrove

Tim Walker Esq
Department of Trade and Industry.

please PIA on Airbus file.

10 DOWNING STREET

David,

The PM said no to Sir J Sterling. She is sure that he has excellent advice to give but is sure he could give that advice to a minister prior to the meeting. She also felt it would cause comment + criticism if he attended.

I have passed the above to Jeremy Godfrey in Tim Walker's absence.

Sue
13.5.87.

PRIME MINISTER

AIRBUS

Mr. Tebbit and Mr. Channon have suggested that it might be useful for Sir Jeffrey Sterling to attend your meeting on Airbus tomorrow morning. Jeffrey Sterling has himself telephoned Nigel Wicks to ask whether it would be possible for him to come.

I see the arguments for Sir Jeffrey's attendance, but feel a bit doubtful about it, admirable man though he is. He of course knows all about the Airbus discussions and will have discussed them in the DTI, with perfect propriety. In logic, there is no difference between that and his attendance at a meeting chaired by you. But I wonder how comfortable British Aerospace, or any other company, would feel if they knew that Sir Jeffrey Sterling had reached the position where he was attending Cabinet level discussions, chaired by you, at which decisions central to their futures would be taken.

Do you wish Sir Jeffrey to attend the meeting? I really don't think we can - especially so near an election.

Either way, could you please tell the Duty Clerk so that she can let Sir Jeffrey know first thing tomorrow morning?

DKN

Any advice he has to offer will have been given to Paul Channon

DAVID NORGROVE
12 May 1987

EL3BXZ

010

CCB/up

P 02680

PRIME MINISTER

AIRBUS

(Meeting of Ministers at 9 am on 13 May)

(Minutes to you of 1 and 7 May from the Trade and Industry Secretary, and of 6 May from the Chief Secretary, Treasury)

CONCLUSIONS

1. You will need to decide:

a. whether a decision to provide British Aerospace (BAe) with launch aid for the Airbus A330 and A340 projects, should be taken and announced this week;

b. if so, what level of aid, and on what conditions, should be offered.

BACKGROUND

2. BAe originally requested launch aid support of £750m, on total launch costs of £840m (plus £280m for production). At your meeting on 26 February you agreed the Government's opening offer should be set at £300m; but that Mr Channon could go up to £420m (50%) subject to further reference to colleagues. The initial offer of £300m was firmly rejected and Mr Channon has conducted further negotiations on the basis that it would be extremely difficult for the Government to go beyond £400m.

Proposals

3. Mr Channon now proposes launch aid of £450m (53.5% compared with the 54% given on the A 320) on the following conditions:-

a. it is fully front loaded (as with the A 320);

b. the Government's target rate of return is set at 7 per cent in monetary terms (as with the A 320) compared with 11.36% for BAe on an assumed £1 =$ 1.30 exchange rate;

c. the Government's return is through fixed sterling levies on sales of over 610 aircraft on a sliding scale, the first 125 being levy free.

4. He rejects 2 other possible options:-

(i) launch aid of £420m with the Government's target rate of return reduced to 5 per cent; the BAe Board rejected this on 5 May;

(ii) launch aid of £500m, with BAe offering to guarantee £75m of their repayment obligation as fixed repayments over the years 1996-98, irrespective of aircraft sales. Both Mr Channon and the Chief Secretary are opposed to this.

MAIN ISSUES

(a) Timing of Decision

5. The first issue to settle is whether you wish to take and announce a decision this week. The Treasury argue that there is no need to do so before the end of June at the earliest and that in the meantime BAe should continue to be pressed to accept a deal more favourable to the Government. Mr Channon, on the other hand, maintains that an early announcement is necessary because the French and the Germans will wish to announce launch aid at the Paris Air Show starting on 11 June; and the German Cabinet are expected to agree to 90% launch aid on 3 June.

6. It would clearly not be impossible to defer the decision and the postponement need not be for very long. The other Governments would understand the difficulties arising from the calling of the election. On the other hand, if Mr Channon is correct, deferral

would leave the UK a little behind the game; and it is well known that the Government have been considering this for many months. You will clearly wish to take wider political considerations into account also in reaching this decision, but if launch aid is announced this week Mr Channon will need, for the sake of propriety, to be able to reasure the House that it is operationally necessary to take a decision of such magnitude so close ~~the~~ to the election.

(b) Nature and Terms of Decision

7. Mr Channon argues that the proposal summarised in paragraph 3 above is the very best he can negotiate out of BAe and that (subject, of course, to the French and Germans confirming their support) we should say snap now and maximise the diplomatic and political credit for it. The Chief Secretary, however, argues that we should seek the following improvements:-

a. launch aid should be restricted to design and development and not front end loaded. This would change the spending profile over the PES period as follows:

	Restricted to Design & Development	£ million Mr Channon's proposal
1987/88	50	55
1988/89	78	107
1989/90	87	157
1990/91	76	131
	291	450

It would, however, leave £159m to be paid after 1990/91.

b. the rate of return to the Government should be increased either by reclaiming levies at an earlier stage or by accelerated repayments of launch aid if BAe's profits are above forecast.

8. There is no doubt that these conditions, if negotiable, would strengthen the Government's position. But the key question is whether they are negotiable. Mr Channon says flatly that they are not. There are also some reasonable arguments on the company's side. The DTI's 'independent' assessors, Morgan Grenfell, advise that it would be unreasonable for the Government to insist on a rate of return equal to that of the company, since the Government's risk is related to aircraft sales (ie that 610 aircraft will not be sold), and that of the Company to costs, prices and exchange rates (though ECGD will be providing export credits on Airbus sales on cover terms). Moreover the commercial prospects for sales of the A330/340s seem better - the latest estimate is 675 aircraft, which is said to be a conservative figure. The total number of orders and options actually so far arranged is 128 (including a preliminary purchase agreement with Northwest Airlines of the US for 30 aircraft).

9. You may conclude that the deal Mr Channon seems able to deliver - which is a considerable improvement on the BAe starting point - is the best the Government are now likely to get and that the Treasury are not really in a position to second guess it. A further consideration is that any significant change to the conditions proposed would almost certainly mean no announcement this week. Even if changes were acceptable to BAe, it would, as I understand it, require a further Board meeting of substance to consider it. But you may wish to probe Mr Channon on this.

TIMING OF ANNOUNCEMENT

10. If you decide in favour of Mr Channon's proposals, you will want to make an announcement very quickly. To do so on Wednesday afternoon would be a bit of a rush and would not allow time for more formal consultation with colleagues. (your 26 February meeting concluded that the issue should be brought to a Cabinet Committee when agreement with BAe was in sight). I suggest, therefore, that you aim for an announcement on Thursday afternoon, after clearance with Cabinet in the morning. This could be on the basis of an oral report by Mr Channon, to avoid circulating a very sensitive piece of paper overnight. It would also give Mr Channon

a chance to circulate a draft for clearance to you and the other Ministers most closely concerned.

HANDLING

11. You will wish to invite the Secretary of State for Trade and Industry to present his proposals, and the Chief Secretary, Treasury to repond. The Lord President of the Council and the Chancellor of the Duchy of Lancaster may wish to comment on the political and Parliamentary implications.

J B UNWIN

Cabinet Office
11 May 1987

BK Tuesday pm.

cc B/UP

PRIME MINISTER

8 May 1987

AIRBUS

I have had the DTI calculate some net present values (NPVs) to show how the former £600m aid programme compares with the proposed front-loaded figure of £450m.

The value to the Government of the £600m deal is minus £20m, when discounted at 10%, and a worse figure of minus £80m for the £450m deal! The explanation is that the lower target rate of return is far more important in deciding the overall cost to Government than the quantity of aid. Nevertheless, the immediate pressure is for the total amount to be kept down and the best way of doing this is to yield on the target rate of return. It is the total sum provided which will hit PSBR over the next few years.

The NPV analysis shows what a topsy-turvy world launch-aid is. If the Airbus investment made any sense in commercial terms, the banks would be clamouring to provide project finance and there would be no need for any Government involvement. The indicated Government rate of return for every case is less than the Treasury bill discount rate, currently around 9.75 per cent. It is therefore unsurprising that, if the target rate of return is reduced from 9.4 to 7 per cent, even a lower initial sum is going to have a worse net present value to Government.

The positive side of what the DTI have negotiated is that, because the initial exposure is lower, the ultimate downside risk is less. If the target sales volume of 610 aircraft is not met we will lose less money by putting up £450m than by putting up £600m. Measured by negative NPV to the taxpayer the present £450m deal is worse than the earlier £600m when 610 aircraft sales are achieved. However, if actual sales

fall short by 25% the NPV of both cases become approximately equal at minus £130m. Any further downside would therefore be protected by the £450m deal.

Conclusions and Recommendation

Our negotiators, led by Mr Channon, tell us that the £450m launch-aid programme, front-loaded and with a target return of only 7%, is the best deal they can make. If that statement is true, then the choice we now have is to accept it, or to turn down Britain's participation in Airbus. The course which the Treasury advocates, namely that our negotiators be told to go away and do better, pre-supposes that they have not squeezed the orange dry and that a better deal is available. However, a £450m settlement will be seen as a major Government victory since it is generally known that Pearce and Lygo originally asked for £750m and then claimed that nothing less than £600m could possibly work.

I do not support the Treasury's proposal that the whole thing should be re-negotiated in order to reduce the front loading. Government will gain a lot of mileage from securing the Airbus project at £300m less than BAe originally asked and external commentators are unlikely to focus on the rate of return targets or the front-end loading. Given, therefore, that it is politically desirable to go ahead with Airbus, I would support the £450m proposal as presented by DTI and not send the negotiators back. It would then follow that the earlier an announcement were made the better.

Julie Bowers
Duty Clerk
pp GEORGE GUISE

PRIME MINISTER

AIRBUS

The minutes below record the Chief Secretary's comments on the deal Mr. Channon has reached provisionally with British Aerospace, and Mr. Channon's comments in reply. There is no requirement for you to read these at this stage.

The Chief Secretary would be content to provide £450 million, subject to a more even spread of payments and an improved return to the Government. He also wishes to see improvements in other respects, including better monitoring.

Mr. Channon does not believe British Aerospace would be prepared to make the concessions the Chief Secretary wishes to see.

This disagreement will need to be resolved by a meeting at some stage. The immediate question is whether there is a need for agreement to be reached before the end of next week.

The Chancellor has heard from his German Treasury contacts that they are unlikely to reach final decisions until the end of June at the earliest. The Chief Secretary would like to use this time for further negotiation. Mr. Channon believes that the French will undoubtedly want to make the anouncement during the Paris Air Show, which starts on 11 June, and that not to do so could damage the commercial prospects of the project. He says the German Cabinet will meet on 3 June and will be pressed by the French to decide, and that the German Treasury's arguments for delay may not win the day.

It again looks as though you will need to hold a meeting next week. I suggest the Lord President, Sir Geoffrey Howe, the Chancellor, Mr. Tebbit, the Chief Secretary and Mr. Channon.

Agree? Yes MT

DRN

David Norgrove

7 May 1987

cc BG
cc B.YP

CONFIDENTIAL
COMMERCIAL IN CONFIDENCE
MARKET SENSITIVE

PRIME MINISTER

AIRBUS

I have seen John MacGregor's minute of 6 May responding to mine of 1 May.

2 I entirely agree, of course, with John MacGregor's objective of securing the best deal we can for the Government and if I thought we could get better terms by continuing the negotiations as he proposes, I would endorse his proposals. However, I am satisfied that we shall not in fact get better terms, particularly in present circumstances. We have after all reduced BAe's demands from £750m to £450m.

3 I too believe the monitoring arrangements are important. I agree with John that if we make an offer of £450m it should be conditional on the company accepting satisfactory arrangements to enable us to monitor both the physical and financial progress of the projects and the overall financial health of BAe. My appointment of Mr Brandon Gough as Government Director would be part of that process. Unfortunately, BAe will not accept a specific right of recourse, but with the monitoring arrangements, I am satisfied that the position is adequately covered.

JF4AVD

CONFIDENTIAL

COMMERCIAL IN CONFIDENCE

MARKET SENSITIVE

4 The front-end loading of launch aid, and the reduction of the Government's target rate of return to 7 per cent, were cardinal features in the overall package enabling me to negotiate BAe down to £450m. I have pressed them very hard and am satisfied that they will not accept any variation of these terms without a corresponding increase in the £450m. Indeed the Board has not yet formally endorsed the £450m package because of some remaining concern that the terms are too onerous to the company, although Sir Austin Pearce believes he can get a formal Government offer through the Board.

5 Precedent is on BAe's side in that front-end loading and a 7 per cent target return to the Government were features of the A320 launch aid agreement. Indeed 7 per cent now represents a higher figure in real terms for the Government than when the A320 deal was struck in 1984.

6 The table at paragraph 2 of John's minute shows only the public expenditure position up to 1990/91. Under my proposal (his right hand column) there would be no further outlay after 1990/91. Under his preferred scheme, there would be a further outlay of £159m after 1990/91.

7 John's point that the Government would bear a higher share of sales volume risk because our return does not start to flow until the 126th aircraft is sold implies that the situation would be better on the £500m option. But this is not so. As my minute of 1 May made clear, the only difference between the £450m and £500m options is that under the latter BAe would guarantee to repay £75m irrespective of the level of sales achieved.

JF4AVD

CONFIDENTIAL

COMMERCIAL IN CONFIDENCE

MARKET SENSITIVE

8 I believe the key point here is our level of confidence in the achievement of the 610 sales, over which the Government's target rate of return will be set. Our current projections indicate good prospects that this level will be achieved. Since I minuted on 1 May, Airbus Industrie have confirmed the valuable preliminary purchase agreement with Northwest Airlines of the US, bringing the total number of orders and options to 128.

9 Again, I accept that there will be additional risks and costs associated with export support, if our present arrangements continue, but the situation here will be the same for each option before us.

10 As to BAe's rate of return, I believe it is reasonable that the company should have a prospective rate of return higher than the Government in recognition of the unequal balance of risk between the parties. As under the A320 launch aid contract BAe will take all the risk on exchange rates, selling prices and production costs. We have seen how on the A320 this has led to a significant shortfall in the company's rate of return below target while our own prospective return has increased.

11 I can understand the argument that one should take into overall account the £150m of estimated costs to BAe of redundancies and plant closures if they do not participate in the projects, and the positive benefits to the company's other business of participation. I believe this has been done by BAe accepting a prospective rate of return as low

JF4AVD

as 11.4 per cent. As I implied in my earlier minute, I think it should be a matter of concern to us if BAe accepted a prospective rate of return any lower than this on such a major high-risk project, given the company's national strategic importance. BAe originally indicated they would want a prospective rate of return of over 15 per cent, and have been negotiated down from that level.

12 On timing, the French will undoubtedly want to make an announcement during the Paris Airshow which starts on 11 June. Indeed not to do so could damage the commercial prospects of the project. The German Cabinet will meet on 3 June and will be pressed by the French to decide. There is no doubt that the Germans will give launch aid of 90 per cent and by no means clear that the German Treasury's arguments for delay will win the day.

13 My own view is that we should conclude a £450m deal with British Aerospace on the terms set out in my minute of 1 May. We shall come under great pressure from our supporters, many of whom have considerable constituency interests. They would find it difficult to understand a delay in our decision, particularly as BAe are prepared to accept such a reduction on their original request. I believe we can gain both political and diplomatic advantage from an early decision and could be disadvantaged by delay. We would of course make clear that our support for BAe was conditional on the French and German Governments also giving their support.

JF4AVD

CONFIDENTIAL

COMMERCIAL IN CONFIDENCE

MARKET SENSITIVE

14 I am copying this minute to Willie Whitelaw, Geoffrey Howe, Nigel Lawson, Norman Tebbit, John MacGregor and to Sir Robert Armstrong.

PC

PAUL CHANNON

7 May 1987

DEPARTMENT OF TRADE AND INDUSTRY

JF4AVD

07. V. PM 8

AEROSPACE; Airbus pt 2

566/4/SC

CONFIDENTIAL
COMMERCIAL IN CONFIDENCE
MARKET SENSITIVE

cc BG
Arthur
cc BLYP

FROM: CHIEF SECRETARY
DATE: 6th May 1987

PRIME MINISTER

AIRBUS

I have seen a copy of Paul Channon's minute to you of 1 May reporting on the present state of play of negotiations with BAe on their application for launch aid for the A330/340. I understand that the BAe Board have now rejected the £420 million package so that the choice currently lies between £450 and £500 million.

2. It is encouraging to note that BAe have now been brought to a more realistic appreciation of the sums the Government is prepared to commit to this programme. On general public expenditure grounds I would be totally opposed to increasing our launch aid offer above £450 million. But, as Paul's minute also makes clear, the deal currently on offer at that figure is disadvantageous to us in a number of very important respects:

(i) because of front-end loading, the spending profile involves substantial outlays over the PES period which could be significantly reduced if launch aid were dedicated to design and development costs only. Broadly, the difference is:

	DEDICATED TO DESIGN & DEVELOPMENT	FRONT END LOADED	DIFFERENCE
1987-88	50	55	+ 5
1988-89	78	107	+ 29
1989-90	87	157	+ 70
1990-91	76	131	+ 55

(ii) the Government is bearing a higher share of sales volume risks because our return does not start to flow until the 126th plane is sold. (We should also, of course, be carrying the risks and substantial subsidy costs associated with providing export credits on sales of Airbus on pure cover terms.)

(iii) The overall target rate of return to the Government is distinctly worse than we have been aiming for (7% as against 9.4%): even if the project is highly successful our return will not rise much above 7%. This contrasts with the return on the project to BAe of over 11%. This figure rises to well in excess of 20% at the company level if account is taken of the avoidance of some £150 million reorganisation costs and the positive cash flow benefits to the remainder of BAe's civil aerospace business associated with their continuing involvement with Airbus. Thus, even if we were to achieve equal returns to the Government and the company on the project, BAe at company level still stand to earn a much higher return on their investment.

3. There are too other important outstanding points, notably on specific recourse to BAe in the event of their default in their obligations to AI and the nature of the monitoring arrangements.

4. Given these unsatisfactory elements I consider that we should continue to press for improvements in the negotiations and I would therefore be against closing a deal with BAe on these terms. In particular I believe that we must continue

to press for the dedication of launch aid to design and development costs so as to achieve a more even spread of public expenditure in the PES period and beyond. We should also seek some increase in our rate of return, either by way of levies starting at an earlier stage (if necessary paid in a lump sum after a certain number of sales have been achieved to assist company cash flow) and/or accelerated repayments of launch aid if BAe's profits are, say, 10% above forecast.

5. On monitoring I note that Paul is considering appointing Mr Brandon Gough as Government director on the BAe Board. The Treasury view is that he would indeed be a good choice. But given the inadequate information about AI's operations hitherto, I would like to be sure that a satisfactory monitoring package has been agreed in detail with the company as part of the launch aid negotiations and not left till afterwards.

6. As far as timing and tactics are concerned, we have avoided being rushed into a decision, despite being presented by AI and BAe with a number of false deadlines. Our latest information on the position of the other Governments is that the Germans at least are unlikely to reach final decisions until the end of June at the earliest. I therefore see a strong case for not reaching final decisions before then. Instead we should continue to press the company to accept a maximum of £450 million conditional on a more even spread of payments and an improved return to the Government. This extended timing would also enable us to sort out any remaining points like the monitoring package referred to above.

6. I am sending copies of this minute to Willie Whitelaw, Paul Channon, Norman Tebbit and to Sir Robert Armstrong.

JM

JOHN MacGREGOR

AEROSPACE: A320 Pt. 2

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MARKET SENSITIVE

Prime Minister 2

I suggest await Treasury comments. (Treasury Ministers are being advised to accept the £450m package but only if the conditions are improved.)

DRN 1/5.

PRIME MINISTER

AIRBUS

1 Since your meeting on 26 February, I have been in close touch with British Aerospace (BAe) and with our French and German partners about the A330/340 projects.

PRESENT POSITION

2 On the Commercial front, the position has improved since February. A detailed assessment is at Annex A, but I now consider that the requirement for a reasonable launch base for the aircraft has been ~~set~~ met. BAe accept, however, that any offer of launch aid should be conditional on a final review of the market position with BAe and our French and German partners.

3 All the signs are that the French and German Governments are moving towards a positive decision within the coming weeks. The German Government will advance 90 per cent launch aid. The French Government may end up with a broadly equivalent scheme involving less launch aid but coupled with equity and guaranteed bond finance. Since Aerospatiale is nationalised, any contribution it makes from its own resources is in practice guaranteed by the French Government.

JG5AVV

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BRITISH AEROSPACE

4 You will recall that the total estimated risk finance required by BAe for the project is £1120m, of which £840m is for launch costs and £280m for production finance. BAe requested launch aid of £750m and quickly came down to £600m. We have been exploring ways of bridging the gap between this and our offer of £400m. BAe have made clear the problem was not the financing of the projects as such, but the level of risk to the company implied by £400m launch aid.

5 BAe argue that if the Government's return was calculated in terms of fixed sterling amounts the Government was insulated from most of the major areas of commercial risk such as exchange rates, selling prices and cost increases. On this basis BAe cannot accept our proposal that the rate of return to the Government and the company should be set at equal levels.

6 Officials argued that £400m launch aid would protect BAe's key forward financial ratios at reasonable levels and BAe have now accepted parts of our argument. Without conceding the point, we have recognised that our offer would in fact leave BAe somewhat exposed on key financial ratios, particularly the likely trend of profits in the early 1990s.

Their ratios would have been better without Royal Ordnance ✓

7 Clearly there is a relationship between the amount of launch aid and the terms on which it is offered, and by varying the terms we have been able to persuade BAe to reduce substantially their original demands. As a result we have identified three possible packages of support, all subject to formal endorsement by the BAe Board. First, BAe would accept £450m on the following conditions:

JG5AVV

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MARKET SENSITIVE

a that the launch aid is fully front loaded (as for the A320)

b that the target rate of return to the Government should be set at per 7 cent in monetary terms, the same figure as for the A320, but now representing a better real return turn to HMG than when the A320 deal was struck. BAe's rate of return would be 11.36 per cent in monetary terms on an assumed long-term exchange rate of £1 = $1.30.

c that the Government's return should be by way of fixed sterling levies on sales over 610 aircraft on a sliding scale, the first 125 being free of levy. When the government's target rate of return has been achieved further royalties would be payable ensuring that the Government benefits from a successful programme.

8 Alternatively, the BAe Board might accept £420m launch aid if the Government's target rate of return was reduced to 5% in recognition of the increased risk to the company. Even so, Sir Austin Pearce tells me he is doubtful whether his Board would give formal endorsement to this option. But if it were our preferred course, the Board would no doubt take that into acocunt.

9 As a third option, if launch aid were increased to £500m BAe would offer to guarantee £75m of their repayment obligation as fixed repayments, spread over three years from 1996-98, irrespective of aircraft sales.

JG5AVV

10 A fixed repayment element would of course be an attractive feature. Such a feature was incorporated for the first and only time in the A320 launch aid contract. However, unless colleagues disagree, I feel it is not worth increasing launch aid to £500m (para 10) in order to get this. We are sufficiently confident that 610 sales will be exceeded to make it in my view reasonable to accept that our return should be by way of levies over that number. BAe consider there is a 75% probability that 610 sales will be exceeded.

11 Launch aid of £420m (para 9), amounting to 50% of launch costs, would obviously be attractive for other reasons but I do not think it right to reduce Government's target rate of return below 7%.

12 If we are to give launch aid, my own view is that the £450m option is the best available course. This represents a marginally lower percentage of the estimated launch costs than our support for the A320 (53½ per cent as compared with 54 per cent). The absence of a fixed repayment element is regrettable, but does not of course affect the target rate of return to HMG.

13 As to the proposed difference in target rate of return to HMG and BAe our own independent advisers argue that it is unreasonable to insist on an equal rate of return when the risks faced by the two parties are so different. The Government's only risk is that 610 aircraft will not be sold on the projected schedule. The company takes all the commercial risk on costs, prices, and exchange rate (assumed to be £1 = $1.30) and I have rejected suggestions that the

government should share in this risk. In the three years since the agreement on the A320, the Government's prospective rate of return has increased while BAe's has reduced.

MONITORING ARRANGEMENTS

14 BAe have accepted in principle that our monitoring arrangements will need to be commensurate with the level of our investment. We shall of course retain our right to appoint a director to the Board. Our present director has recently retired and I am considering appointing in his place Mr Brandon Gough, Senior Partner of Coopers and Lybrand.

PUBLIC EXPENDITURE

15 At £450m, our launch aid would be payable approximately as follows:

	£M
1987/88	55
1988/89	107
1989/90	157
1990/91	131
	450

16 As I indicated in my note of 24 February, established Treasury procedures prevent any provision being made for A330/340 launch aid in my Department's PES figures, so it would be impossible for the DTI to accommodate any agreed support within its PES baselines.

JG5AVV

ROYAL ORDNANCE

17 The purchase of Royal Ordnance by BAe for £~~180~~190m might suggest that their position on the A330/340 is unreasonable. In fact, BAe have always made clear that raising the finance for the A330/340 is not in itself a problem. It is the risk attached to the A330/340 including exchange rate and theprices obtained, which BAe find unacceptable as a plc, and this is not affected by the RO purchase. In BAe's perception, RO is a relatively low risk investment, involving none of the international commercial risk (including exchange risk) that characteries a civil aircraft project.

INLAND REVENUE

18 I understand the Inland Revenue have recently been reviewing the tax position of BAe's work on Airbus. Clearly a significant change to the current arrangements could have an adverse effect on BAe and my recommendations assume that it will be possible to give BAe a satisfactory assurance on this tax point.

RECOMMENDATION

19 I am satisfied that the three options set out above represent the limit of what BAe will accept. I have had several meetings with Sir Austin Pearce and Sir Raymond Lygo and have impressed on them as seriously as I can the difficulty for us in going beyond £400m on the terms I originally offered. However, I am persuaded that this would imply an unreasonable level of risk for BAe which, quite apart from their unwillingness to take, it would be unwise on

our part to drive the company to accept. I will be in a position to report further on the views of the BAe Board early on 5 May.

20 I have told British Aerospace that I will consider these proposals and will consult my colleagues but of course have given no indication of our likely attitude. My view is, however, that on both political and industrial grounds we should accept one of the 3 options. My own preference is for launch aid of £450m.

21 I am copying this minute to Willie Whitelaw, Nigel Lawson, Norman Tebbit, John Macgregor and to Sir Robert Armstrong.

P.C.

PAUL CHANNON
1 May 1987

DEPARTMENT OF TRADE & INDUSTRY

JG5AVV

ANNEX A

COMMERCIAL PROSPECTS

In March Airbus Industrie announced that they had obtained nine airline commitments for 104 A330s and 340s. Since then one small airline (Finnair) has withdrawn. But this has been more than offset by the addition of a conditional commitment from Northwest Airlines of the US for 30 aircraft. This breakthrough into the US market, if confirmed, would be very encouraging for Airbus. Meanwhile the competition, represented by the McDonncll Douglas MDll has secured some 115 commitments, inevitably benefiting from its status as a formally launched project.

2 Publicity has surrounded the deferment of the planned development of the V2500 Superfan engine for the A340 by International Aero Engines (IAE), in which Rolls Royce has a 30 per cent share. The programme has not been cancelled; indeed IAE are still in close consultation with Airbus about it. However IAE decided they could not prudently guarantee their previously suggested delivery date of 1992. The A340 will therefore be offered initially to airlines only with an improved version of the GE/SNECMA CFM 56-5 engine, with the possibility of the V.2500 Superfan being offered at a later stage as an alternative. Rolls Royce have for the time being withdrawn their request for launch aid for the V.2500 Superfan.

French

4 Provided the airlines with A340 commitments accept the offer of the improved CFM 56-5 engine (which we expect to be confirmed shortly) I now consider that the requirement for a reasonable launch base for the aircraft has been met. Our French and German colleagues are likely to be of the same

JG5AVX

view. We had originally jointly suggested to Airbus Industrie a launch criterion of 50 orders for the A340 and 30 for the A330, including orders from one US airline.

5 Overall, the encouraging commercial developments of the last two months have tended if anything to increase my advisers' confidence that a "most likely" total sales figure for the A330/340 might be 675. Indeed this should now probably be seen as a relatively conservative figure.

JG5AVX

David

We spoke

With the Compliments
of the
Chancellor of the Exchequer's
Private Secretary

Tony

Treasury Chambers,
Parliament Street,
S.W.1.

CONFIDENTIAL

FROM: T U BURGNER
DATE: 1 May 1987

CHANCELLOR

cc Chief Secretary
Financial Secretary
Sir P Middleton
Mr F E R Butler
Mr Monck o.r.
Mr Turnbull
Mr Robson
Mr G M White
Mr Bent
Mr Hughes
Ms Huleatt-James
Mr Tyrie

BAe LAUNCH AID APPLICATION FOR A330/340

We have been told that Mr Channon will be writing to a small group of colleagues today reporting on the position he has reached in negotiations with BAe and making recommendations for further concessions. We have not yet seen his letter. There is a risk that the Prime Minister may want to discuss Mr Channon's minute following the discussion on Mergers Policy at No.10 on Tuesday, although Mr Channon himself will not suggest this. This briefing, based on an oral report by DTI, is intended to deal with that contingency.

State of Negotiations

2. As you will recall, DTI have made an offer of £400m in response to BAe's request for £750m launch aid, with authority to go up to £420m. DTI have now reached the position where they believe they can do a deal with the company on the basis of £450m but with terms and conditions a good deal worse than the Government has been seeking. Alternately there are possible deals at either £420m or £500m but these look even worse.

3. DTI believe that they have taken the negotiations as far as they can and that further improvement is not likely to be forthcoming.

A £450m Deal

4. The main characteristics of a deal at this level would be as follows:

The £450m launch aid would be front end loaded and would be paid on the basis of:

£ million

1987-8	1988-9	1989-90	1990-91
55	107	157	131

This gives a total launch aid of something over 53%.

5. The Government would receive a 7% monetary return spread over 610 sales, the first 125 being levy free. No fixed (lump sum) repayment would be incorporated. The company return would be 13.4%. They will not accept the proposition that the Government's rate of return should be equal with theirs, arguing that they are carrying the greater share of the risk (including on the exchange rate and the selling price). For sales over 610 the Government would receive royalty payments, the amounts still to be negotiated. Depending on sales, this could improve the Government's rate of return but probably by less than 1%. (The 7% nominal rate of return is the same as for the A320. For the A320 this was intended to yield 2% real; for the A330/340 lower inflation should mean a higher real return.) DTI's confidence in the sales total has strengthened and they now think that their own estimate of 675 is somewhat conservative.

6. Among the terms and conditions which have not so far been secured are:

(i) Accelerated repayment if BAe's profits are 10% higher than the company's forecast. The company do not apparently have objections in principle, but DTI and MOD are concerned about enforcing this and have clearly not pursued it with any enthusiasm.

(ii) The company accept greater monitoring in principle "commensurate with the Government's stake" and details have still to be agreed. This seems to leave considerable scope for company back-sliding.

(iii) Recourse - there is no agreement on any right of recourse to the company if the guarantees on this project are called. BAe object both in principle, arguing that the guarantees to AI are part of the Government's share of the risk; and also on the grounds that recourse would feature as a contingent liability in their balance sheet.

A £420m deal

7. The level of launch aid is slightly reduced, but the Government's rate of return falls from 7-5% nominal. Alternatively the company would want the A320 contract reopened to remove the fixed repayment which BAe are due to make in 1991 and 1992 or to have this fixed repayment recycled as launch aid for the A330/340. Both these alternatives are extremely unattractive. This option is not worth pursuing.

A £500m deal

8. The additional £50m of launch aid would purchase a fixed repyament of £75m to the Government over 3 years 1996-98 but the target rate of return for the Government would still be 7% nominal. This is even less attractive: not worth pursuing.

Assessment

9. Ministers will be under considerable pressure to agree a deal of some kind. Mr Channon will argue that DTI have bought the company a long way (from its opening bid of £750m and its more recent position of £600m) and that the gap between what was previously agreed and what is available is now a small one.

10. But this is misleading in two important respects.

(i) The front end loading of the £450m means that the outflow in the PES period will be considerably higher under the £450m deal, vis

£m

	420	450
1987-88	50	55
1988-89	76	107
1989-90	80	157
1990-91	76	131
1991-92	75	-
1992-93	55	-
1993-94	8	-

In terms of PES there is a distinct deterioration. If we could get the company to spread the figures more evenly by dedicating launch aid to design and development costs the effect would be improved.

(ii) The overall rate of return to the Government is distinctly worse than we wanted (7% as against 9.4%.) While it would be possible to defend 7% at the PAC (as the DTI have recently done for the A320), it is arguably a poor return for the risk that the Government is carrying. If the plane is not a commercial success, the Government will not achieve 7%. If it is highly successful, the rate of return will improve relatively little above 7%.

Possible ways of improving the deal

11. There are a number of possible ways in which the deal could be improved. A possible line would be to indicate readiness to accept £450m launch aid if some or all of the following improvements could be made in negotiation.

(i) The launch aid to be dedicated to design and development costs - see above. This smooths the payments and brings worthwhile improvements during the PES period.

(ii) Negotiate better royalty payments above 610 sales than have been agreed for the A320. If the plane is a runaway success, the Government's rate of return ought to be substantially higher than 7%.

(iii) Insist on accelerated repayments if BAe's profits are above 10% better than forecast. It is DTI and MOD who are against this rather than the company. The fact that Government action may affect BAe's profits is not an argument against. If Government action improves BAe's profits, we shall only be getting back a small part. If Government action depresses BAe's profits we as well as they will be the losers under this formula.

(iv) Levies should accrue for the first 125 sales, rather than their being levy free. But in order to help the company's cashflow, the accrued levy would be paid in one or more lump sums after the 125 sales point has been passed.

(v) We need to get a proper monitoring package agreed as part of the deal, not as something to be negotiated after the deal has been struck. We should not allow BAe to get away with weasel words about a monitoring package "commensurate with the Government's stake".

(vi) We should try, if at all possible, to get some degree of recourse to the company for the new liabilities to AI that the Government is taking on. The Government has a large and unquantified contingent liability in relation to AI and we do not want to see it grow with the new launch aid agreement. This is a point that has exercised the PAC.

12. A number of these points have the effect of improving the likely rate of return for the Government which appears to be a sticking point for the company. Even if one accepted the company's principle about unequal rewards being appropriate, there is nothing sacred

about the present gap. But it is clearly a matter of judgement how far these negotiating points are attainable within the framework of a £450m deal. As a minimum, I would be inclined to insist on a good rate of royalties for sales above 610; accelerated repayment if BAe's profits are higher than expected; and a water-tight monitoring package. But it would be good to get more than this if possible.

13. I understand that Mr Channon's minute will refer to a tax problem that BAe have with the Revenue. Apparently a deal is dependent on getting an assurance from the Revenue about the tax treatment of BAe's involvement in Airbus. DTI are separately in contact with the Revenue about this. Any discussion on this point ought to be avoided at your meeting.

Latest background on A330/340 position

14. According to DTI the position on options and firm orders for the two aircraft is generally satisfactory - a total of 128 orders or options for the two aircraft involving 9 airlines. In a number of cases the airlines have yet to indicate that they will take the CFM 56 engine in place of the IAE which has been delayed, but DTI seem confident that they will. Any launch aid offer is conditional on there being a satisfactory market position but that criterion seems likely to be met.

15. Both the French and the Germans are apparently moving to a position to announce their launch aid proposals in the next 3-4 weeks. The Germans are likely to award 90%. The French position is more complicated because they will be giving part of their aid in a form that will help to prepare Aerospatiale for privatisation. Their total package of assistance may be around 75% with the launch aid element somewhat less than this.

TB

T U BURGNER

06

David.

Minute review arrived

per 21/4

CABINET OFFICE

With the compliments of

J. B. UNWIN

70 Whitehall, London SW1A 2AS
Telephone 01 233

AB

For note. I suggest show the note to the PM

CONFIDENTIAL

P 02636

From: J B UNWIN
9 April 1987

COPY FOR

MR MONGER

cc Mr Norgrove - No 10
(for info)

Subject to what it says, you should I think invite her to agree to a meeting after Easter.

AIRBUS

I understand from Mr Channon's office that talks between officials and British Aerospace are not making much progress. They are exploring the likely terms of the Government's launch aid (timing of payments etc) to see whether there is any trade off here between this and the total sum, but the prospects are not very promising. Apart from this, the only flexibility left to the Secretary of State will be to go up from £400 to £420 million.

2. The Chairman of British Aerospace has asked to see Mr Channon next Monday. Subject to this, Mr Channon will report to the Prime Minister next Tuesday, probably with a view to a further Ministerial meeting after Easter.

J B UNWIN

with Ch/Ex
Channon
Tebbit
FCS (Note that he was not at the last meeting & you ought to get the PM's permission for him to come.)
DBS
9/.

permission.

CC BG

DEPARTMENT OF TRADE AND INDUSTRY
1-19 VICTORIA STREET
LONDON SW1H 0ET
Telephone (Direct dialling) 01-215) 5422
GTN 215)
(Switchboard) 01-215 7877

Secretary of State for Trade and Industry

CONFIDENTIAL
COMMERCIAL IN CONFIDENCE

6 April 1987

The Rt Hon John MacGregor OBE MP
Chief Secretary to the Treasury
Treasury Chambers
Parliament Street
London SW1P 3AG

Dear John,

NBPM

A330/A340 LAUNCH AID: IMPLICATIONS OF BAE BID FOR ROYAL ORDNANCE

Thank you for your letter of 26 March about the possible implications for my negotiations with BAe on launch aid of their bid for Royal Ordnance, which has now of course been sold to them, subject to there being no reference of the sale to the Monopolies and Mergers Commission.

I do not have the information available to you about the financial situation of Royal Ordnance, but I very much agree with your view that we should resist robustly any suggestion by BAe that we should increase our launch aid offer because of their acquisition of the Company. I believe that the two issues should be regarded as quite separate.

I am copying this letter to the Prime Minister, George Younger and to Sir Robert Armstrong.

Yours,

Paul

PAUL CHANNON

JG5ATB

999-1

AGROSPACE : Airbus PT2

002/2985

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CC BG

Treasury Chambers, Parliament Street, SW1P 3AG

The Rt Hon Paul Channon MP
Secretary of State for Trade and Industry
Department of Trade and Industry
1 - 19 Victoria Street
London
SW1H OET

N Bottomley this stage

26th March 1987

Dear Paul,

AIRBUS A330/A340: IMPLICATIONS OF BAe BID FOR ROYAL ORDNANCE (RO)

As you are aware, BAe are one of the two companies now in negotiation with the Ministry of Defence for the purchase of RO. I have been considering the possible implications for your negotiations with BAe on launch aid.

Clearly the final decision on which company we should sell to must be decided on the basis of the price and terms offered. If BAe emerge as the clear winner then they must be the preferred purchaser.

However, we must be alive to the impact on BAe's case for launch aid. As you know, this is based on a number of key financial criteria/ratios, two of which would be significantly affected if BAe were to buy RO. These are dividend cover and gearing. On the basis of 50 per cent launch aid (i.e. our agreed negotiating ceiling) and assuming, for illustrative purposes only, a purchase price of around £200 million is financed at the margin by additional borrowing, the effects of the BAe bid for RO could be as follows:

	1987		1988		1989	
	CURRENT	WITH RO	CURRENT	WITH RO	CURRENT	WITH RO
. DIVIDEND COVER	2.2	2.5	1.4	1.6	2.0	2.3
. GEARING (%)	9	20	20	29	21	30

The effect on dividend cover is helpful to our case because of the positive impact of the RO acquisition on BAe profits. Gearing is increased substantially, but remains within the one-third criterion which the company regard as the maximum acceptable in their circumstances.

BAe are not slow to use all available negotiating tactics (including extensive media briefing) so I would not be surprised if BAe sought to make negotiating capital out of this issue. I am sure that you will agree, however, that we should respond very robustly should there be any suggestion by BAe that we should increase our launch aid offer on this account. There are three key points to be made:

- BAE's decision to purchase RO is a commercial matter for them and highlights their ability and willingness to finance investment. There can be no question of the Government effectively being asked to pick up the bill for this via launch aid;

- the acquisition should serve to improve their dividend cover and, in two out of the three years, take it above the threshold of 2.2 the company have set themselves. And though gearing increases substantially it still remains below the BAe ceiling of one-third.

- Any higher level of launch aid (e.g. the figure of £600 million reported in your minute to the Prime Minister of 10 March), would not change the dividend cover and gearing ratios for the first three years. This is because higher assistance will not be reflected in higher payments in the early years as the launch aid baseline figures already assume 100 per cent front-end loading.

I am copying this letter to the Prime Minister, George Younger and Sir Robert Armstrong.

Yours ever,

JOHN MacGREGOR

cc. G Guise

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COMMERCIAL IN CONFIDENCE
MARKET SENSITIVE

Prime Minister
For information at this stage. A meeting may well be needed next week.
DRN 13/3

PRIME MINISTER

AIRBUS A330/A340 LAUNCH AID

I have seen John MacGregor's minute to you of 11 March questioning my proposal that I be authorized to attempt to reach a settlement with British Aerospace before 13 March on a conditional offer of £500m in launch aid.

2 I should first of all report that I wrote to Sir Austin Pearce of BAe this morning formally offering £400m in launch aid and requesting a reasoned response from him. So far this has not been received, and all the indications are that the offer will be rejected by the BAe Board.

3 Our Embassy in Paris have heard informally today from a contact in the Elysee that it is highly likely that Airbus Industrie will announce at the meeting of its Supervisory Board on 13 March that appropriate conditions, in terms of airline customers, now exist for launching the A330/A340 programme. This probably means that Aerospatiale, the French partner, is ready for such an announcement. My officials heard from their German colleagues yesterday that MBB, the German partner, is expected to support the launching of the programme, subject to financial support from the German Government. British Aerospace consider that supporting an Airbus Industrie resolution concerning the launch of the A330/A340 would lock them into the new programme morally if not legally. This is the main reason

JF4ARX

why they have been pressing the Government to make an acceptable launch aid offer by 13 March.

4 As far as Governments are concerned, Ministers of all four Airbus partner countries have told Airbus Industrie that no firm decisions are to be expected from Governments on financial support for the A330/A340 before the meeting on 13 March. This should mean that any decision to launch the programme will be subject to negotiations with Governments on financial support, but the French, German and Spanish companies, since they are wholly or partly publicly owned, have a higher degree of confidence in obtaining the necessary backing than BAe.

5 If Airbus Industrie do make a launch announcement on 13 March, there will obviously be increased pressure on Governments, especially the UK Government, to take decisions before the end of March on the provision of financial support. We could well face problems in Parliament, including ones with our own supporters, if agreement with BAe is not reached very soon. The speculative report in today's Guardian that the Government had made an offer of less than £400m in loans for the A330/A340, and that the offer was unacceptable to BAe, was unhelpful in this respect. I think it would be wrong, in answer to a direct Question in the House, not to say that I had made an offer to the Company, and that this was under discussion with them. However, no Question of this nature has so far been asked, and the DTI Press Office, and British Aerospace, are continuing to take the line that BAe's request for launch aid is still under discussion, and that decisions will be taken as soon as possible.

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MARKET SENSITIVE

6 I should like to point out, with regard to John MacGregor's comment concerning the conditions of any launch aid, that my offer of £400m was made on the same terms and conditions as the original offer of £300m, and that I would not make any increased offer without the accompanying conditions.

7 I shall report to you further on my negotiations with the Company in the light of any decisions and announcements by the Airbus Industrie Supervisory Board on 13 March.

8 I am copying this minute to Willie Whitelaw, Nigel Lawson, Norman Tebbit, John MacGregor and to Sir Robert Armstrong.

PC

PAUL CHANNON

12 March 1987

DEPARTMENT OF TRADE AND INDUSTRY

JF4ARX

MR 2/29

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Prime Minister
This has not been copied to other Ministers, but they are indirectly being told the substance.
(The Chancellor does not want to seem to be going behind Mr Channon's back.)

DRN 13/3

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

David Norgrove Esq
10 Downing Street
LONDON SW1

12 March 1987

Dear David

AIRBUS: DISCUSSION WITH HERR STOLTENBERG

The Chancellor telephoned Dr Gerhard Stoltenberg, the German Finance Minister, this afternoon to discuss Airbus. The Chancellor explained that he was very concerned that attempts were being made to rush a decision through when there were still questions to be answered about the project's commercial and financial prospects.

Stoltenberg agreed with the Chancellor. He was coming under some political pressure himself. The German position was that they had agreed to contribute a significant amount to Airbus development, but with two important pre-conditions:

(a) there had to be agreement with their French and UK partners; and

(b) there had to be greater participation by the German company, as opposed to the German taxpayer.

The Germans had already made provision in their Budget for the public expenditure which would be required, but this money would not be released until the Budget Committee and the Finance Ministry were satisfied that the conditions had been met. Stoltenberg asked what the UK position was.

The Chancellor explained that no final decision had been taken yet. We had not made provision for the public expenditure in our Budget, but would be prepared to make funds available if the case were made out. However, the commercial prospects of Airbus were doubtful. HMG would require British Aerospace to take a substantial part of the risk, not leaving it all to the taxpayer. His expectation was that HMG would offer some launch aid, but possibly not enough for British Aerospace to decide to go ahead.

Stoltenberg said that, although the Germans may have got a bit further down the road than the UK, the requirement for stronger participation by the industry was important for them too. It would take the Economics Minister (Herr Bangemann) some time to reach agreement on this point - perhaps two months or more. Meanwhile, the German company always gave

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the German Government very rosy accounts of what the French and UK Governments were coming up with, so it was useful to have this Finance Minister to Finance Minister contact.

Stoltenberg went on to say that what really concerned him was the need for some sense of priorities. Some of his colleagues seemed to think that we could support Airbus, and go on to join the various international space projects (Columbia, Hermes, etc) as well. He tried to explain to his colleagues that it was just not possible to find the money for all of these. The Chancellor shared this sentiment. He had felt it important that Airbus and space were discussed together, for just the reasons Stoltenberg had given. The likely return on space projects was ridiculously low. Stoltenberg agreed, but said that colleagues found the fascination of high technology and European collaboration irresistable.

European R & D

Stoltenberg then mentioned that there would be a meeting of R & D Ministers in a few days. He asked whether the UK was sticking firmly to its existing position? The Chancellor confirmed that we were. Stoltenberg said he had made it clear to his Ministerial colleagues that Germany could not go beyond the present position either, although they were looking at ways of making the message more acceptable to the Commission.

Yours ever,

Tony

A W KUCZYS
Private Secretary

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COMMERCIAL IN CONFIDENCE - MARKET SENSITIVE

cc G. Guise

FROM: CHIEF SECRETARY
DATE: 11th March 1987

Prime Minister
You discussed with the Chancellor.
11/3

PRIME MINISTER

WITHDRAWN?

AIRBUS A.330/340

I have seen a copy of Paul Channon's minute to you dated 10 March seeking agreement to increasing before Friday the Government's launch aid offer to BAe to £500 million. I question whether we should make any increase to our offer at the present time.

2. There are several reasons why I believe we should stand firm. First, Paul has already moved from the Government's opening offer of £300 million and indicated to the company that we might offer £400 million. As his minute makes clear, the company are considering that position. It makes no sense in terms of negotiating tactics to rush in now with yet a further increase to our offer.

3. Second, I do not see that it is critical to have an agreement with the company before the Airbus Supervisory Board meeting on Friday. The timing of the meeting is not a new factor. The company must have realised that they were unlikely to have reached a firm agreement with the Government before then and must expect to have to play their hand accordingly. In any case it is far from clear how far the French and German companies have got in discussions with their own Governments. I do not know whether it is right, but today's Financial Times reports that they are not yet ready to give a green light.

4. Third, in making his initial offer last Monday, Paul rightly linked this with a number of other conditions, some of which have important financial implications. There is no possibility of getting these agreed before Friday - indeed we shall be on weaker ground in pressing for these conditions if we agree a figure for assistance in advance.

5. The reaction of the company to our opening offer is surely in no way surprising. They are a tough, commercially orientated board, engaged in an important set of negotiations in which they have a lot at stake. We must expect them to look for opportunities to put pressure on us. But having made a reasonable offer, I am sure it is right to leave it with the company.

6. I am copying this minute to Willie Whitelaw, Paul Channon, Norman Tebbit and Sir Robert Armstrong.

JM

JOHN MacGREGOR

cc BA & return

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MARKET SENSITIVE

Seen by the Prime Minister
11/3.
DRN

PRIME MINISTER

AIRBUS A330/340

As agreed at your meeting on 26 February, I have made a conditional offer of £300m launch aid to British Aeroapace. This compared with their request for £750m out of their total estimated exposure on development and production of the aircraft of £1,120m.

2 Unfortunately, the British Aerospace Board has made clear its view that the amount proposed is unacceptable, and that BAe could not participate in the projects on that basis. As I said when we met, their main argument is that as a PLC they cannot responsibly accept the level of risk involved. They also point to the substantially greater support expected to be offered to their partners by the French and German Governments.

3 In BAe's view, the timing is now critical. They are required to attend a meeting on Friday of the Supervisory Board of Airbus Industrie, at which resolutions to launch the projects will be tabled. Even though neither the French nor German Governments have yet concluded firm launch aid arrangements with their companies, BAe believe their partners will be sufficiently confident of their position to go ahead. Sir Austin Pearce, however, is clear that he could only responsibly take a similar position if he was reasonably confident of reaching agreement with the Government.

JF2AET

4 I made clear to him that there was no possibility whatever of the Government accepting BAe's demand for £750m. After reflection, Sir Austin has come back to me today and said he believes his Board might be prepared to go ahead on launch aid of £600m (implying that BAe take the risk on the remaining £520m of estimated development and production finance required).

5 In return I have indicated, within the terms of our discussion on 26 February, that the Government could offer £400m. The present position is that the BAe Board is considering that position and I have undertaken to consider theirs.

NEXT STEPS

6 I believe BAe may be right that their partners will be prepared to give the go ahead on 13 March even though they have not reached firm launch aid arrangements with their Governments. In these circumstances I accept that it would be desirable to put BAe into a position where, whatever qualification they may necessarily have to put on their position, they can be reasonably confident that an agreement will be reached with the Government enabling the company subsequently to confirm agreement to the launch of the projects.

7 I do not believe an offer of £420m (the maximum discussed at your meeting on 24 February) will secure agreement. But I would suggest that in further discussion with the company you should authorize me to go up to £500m, subject to confirmation by colleagues, on the understanding that I make clear to BAe that we would go no further.

JF2AET

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MARKET SENSITIVE

8 £500m (representing some 59 per cent of BAe's estimated development costs) is in fact within the range judged by our merchant bank advisers (Morgan Grenfell) to be justifiable. While I do not necessarily accept in full BAe's assessment of the risks they face, I would agree with them to the extent that it is not in any of our interests to subject this newly privatised company to excessive risk. Moreover even at a £500m level, our launch aid is likely to be substantially less that the support the French and German Governments will give.

CONCLUSION

9 My proposal is that I be authorized to attempt to reach a settlement with BAe before Friday on an offer of £500m, subject to the same conditions as before and to make it clear to BAe that this was as far as we would go.

10 I am copying this letter to Willie Whitelaw, Nigel Lawson, Norman Tebbit, John MacGregor and Sir Robert Armstrong.

P.C.

PAUL CHANNON

10 March 1987

DEPARTMENT OF TRADE AND INDUSTRY

JF2AET

AEROSPACE

A320

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cBG
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POLICY
PT2

10 DOWNING STREET

LONDON SW1A 2AA

From the Private Secretary

MR UNWIN
CABINET OFFICE

SPACE, AIRBUS, HELICOPTERS, ETC.

You asked (your minute of 3 March to Mr. Monger) whether I saw any objections to taking the proposed paper on space on its own at E(A), ahead of discussions of airbus and Westland.

That seems now unavoidable and I am sure the Prime Minister would be content for space to be taken separately.

However, I think it would be useful for Mr. Channon to mention to E(A) his discussions with British Aerospace over launch aid for Airbus. One Minister at least is aware that the Prime Minister has discussed this with a small group of colleagues and it would be in any case a little disingenuous for the prospect of future public expenditure claims to be mentioned at an E(A) on space without reference to the discussions with British Aerospace. Mr. Channon, in introducing his paper, might simply say that he is exploring with British Aerospace the basis of their bid for launch aid, with a view to reducing it very substantially. This would simply take it for granted that the Government would be offering launch aid, with the only uncertainty being the amount.

I have mentioned this to Mr. Gilbertson in Mr. Channon's Private Office, who believes that his Secretary of State would be willing to say something along those lines.

I am copying this minute to Mr. Monger and Dr. Walker.

DAVID NORGROVE

3 March 1987

VC

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CONFIDENTIAL

P 02547

From: J B UNWIN
3 March 1987

MR MONGER

cc Mr Norgrove - No 10
Dr Walker

COPY FOR

SPACE, AIRBUS, HELICOPTERS ETC

I have discussed developments with Alastair Macdonald at DTI. The position in brief is:-

(i) Space: DTI hope to have a paper for E(A) on the lines agreed by the end of this week;

(ii) Airbus: because of Mr Channon's absence, no follow-up action has been taken so far. The tentative plan, however, is for Mr Channon to meet British Aerospace next Monday and hand over a letter setting out the Government's proposal;

(iii) Helicopters: Sir John Cuckney has asked to see Messrs Channon and Younger again next Monday. The likelihood is that he will say that the EH 101 offer is inadequate; unless it is brought forward, or other orders interposed, Westland will have to close all or most of their helicopter business, including the 2,000 jobs at Weston-Super-Mare. The choice will then be between letting this happen or finding extra cash (probably from the Reserve) to bring forward orders and fill the gap.

2. We must decide how to handle this in relation to E(A). We have provisionally booked an E(A) slot for after Cabinet on Thursday, 12 March. It is clear, however, that neither the Airbus nor Helicopter papers will be ready by then. The Space paper should, however, be available. We had hoped to be able to take them all together, so that Ministers could consider the competing priorities together. But I suspect that the Airbus and Helicopter

issues could drag on for several weeks. The Prime Minister may well in any case wish to have a further discussion of either or both of them in a small Group before they go to E(A).

3. The choice is between taking Space on its own at E(A) on 12 March (provided the paper is in reasonable shape by early next week) or postponing it until the other issues (or at least Airbus) are ready. I am inclined to go for the former. We shall have achieved our objective of ensuring that the other competing claims are in the key Ministers' sights, and we can brief the Prime Minister on the latest developments. But I should be glad to know whether Mr Norgrove sees any objections.

J B UNWIN

SUBJECT
cc made.

SECRET 5

file NAJ

10 DOWNING STREET
LONDON SW1A 2AA

From the Private Secretary

26 February 1987

Dear Michael,

AIRBUS

The Prime Minister this morning held a meeting to discuss launch aid for the Airbus A330 and A340 on the basis of your Secretary of State's minute of 24 February. There were present your Secretary of State, the Lord President, Chancellor of the Exchequer, Chief Secretary, Mr Brian Unwin, Cabinet Office and Mr George Guise, No.10 Policy Unit.

Your Secretary of State said the decision on launch aid was likely to be very controversial. It would be needed not much later than the beginning of April. Aerospatiale and MBB would effectively be given 100 per cent launch aid, either directly or through guarantees. British Aerospace would only remain in the programme if they were given some launch aid. The Board was split on whether BAe should remain in the civil aerospace business, with the non-executive directors arguing that the company should withdraw. This was not however the view of Sir Raymond Lygo.

The Chief Secretary referred to a number of pressures for higher public expenditure, many of them in the area of industry and research. BAe had a healthy balance sheet and would face costs of around £150m. if it were to withdraw from civil aerospace. There were also spin-offs for the rest of the business. On this basis it should be possible to confine Government launch aid to no more than 40 per cent of BAe's total share. The method of giving launch aid could be resolved separately. On balance it seemed better for the Government to reach a decision quickly, rather than late, in order to try to influence the decisions to be taken by France and Germany.

After discussion it was agreed that the Government should seek to move to an early decision. However it seemed most unlikely that BAe would settle for 40 per cent launch aid, whereas 50 per cent might be negotiable. (Earlier launch aid for Airbus had been set at some 54 per cent). The Government's opening offer should be set at 35 per cent

which might be expressed as, say, £300m. if your Secretary of State thought that would be preferable. Your Secretary of State would need to make it clear in discussion that he had no formal approval from Cabinet for his offer. He would not wish to commit to 50 per cent without further reference to colleagues. A paper should be brought to a Cabinet Committee when an agreement with BAe was in sight. The manner in which launch aid would be given should be discussed with the Treasury.

I am copying this letter to Joan MacNaughton (Lord President's Office), Alex Allan (HM Treasury), Jill Rutter (Chief Secretary's Office), Andrew Lansley (Chancellor of the Duchy of Lancaster's Office) and Brian Unwin (Cabinet Office).

Yours,

David.

David Norgrove

Michael Gilbertson Esq
Department of Trade and Industry.

10 DOWNING STREET
LONDON SW1A 2AA

From the Private Secretary

Prime Minister

Mr. Tebbit telephoned to say that he is unwell & will not be able to make Cabinet, or the meeting on Space & Airbus. On the latter his views are:

(a) he is more sympathetic to the Airbus, provided costs can be kept within reasonable limits and outright subsidies

avoided.

(b) he is very much <u>less</u> sympathetic to expenditure on <u>space</u>, and would not support anything on the scale proposed.

CDP

cf Blue

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P 02536

PRIME MINISTER

The UK National Space Plan: Launch Aid for the Airbus A330 and A340 projects

CONCLUSIONS

The eventual decisions that you will need to take are:-

(i) On Space

a. to what extent to endorse the UK National Space Plan and the specific actions recommended in paragraph 22 of E(A)(86) 60;

b. how the cost should be accommodated.

(ii) On the Airbus

a. whether the Government should agree to help BAe with development costs.

b. If so, whether the support should take the form of launch aid or interest support.

2. You will no doubt want to reach a preliminary view on these issues at this meeting. But its prime purpose is to decide how best to bring them forward to E(A) for later decision.

BACKGROUND

3. On Space, E(A) was unable to take decisions on Mr Channon's

proposals before Christmas. The Cabinet Office were asked to prepare a paper reviewing Government expenditure programmes on industrial support and R & D. E(A)(87) 6 is the result. Its intention is to enable Ministers to set the Space bid against other comparable existing and potential claims on resources. The Chief Scientific Adviser has also set out his recommendations on space in E(A)(87) 7.

4. On Airbus, Mr Channon's minute of 24 February covers a voluminous DTI paper. There has not been time to analyse this or discuss it with other Departments. This will be necesssary before E(A) meets.

Proposals

5. The two sets of proposals add up to a very considerable bid for new spending. On Space, Mr Channon proposes an overall UK contribution of 14 per cent to the European Space Agency (ESA) programme agreed in January 1985; and a substantial increase in our national programme along the lines of the UK National Space Plan.

6. On the Airbus, BAe asked for help of £750m towards their share, £840m, of the development costs of the proposed A330 and A340 projects. The DTI have suggested instead £336m, rising if necessary to £420m. The public expenditure consequences depend on whether the help is given by launch aid (capital payments) or interest support (borrowing guarantees and interest payments).

7. In addition Rolls Royce intend to ask for £75m launch aid towards the development costs of the Superfan engine, but a decision is not sought on that now.

8. These proposals would produce the following profile of extra public expenditure in the PES period:

	£ million (Cash) 1987/88	1988/89	1989/90
Space (Civil)			
[Present provision]	112	113	119
Mr Channon proposes	+ 75	+125	+170
Mr Fairclough proposes	?	?	+131
Airbus			
Assuming launch aid	+ 45	+ 80	+ 78
Assuming interest support	+ 2	+ 9	+ 16

There are no details of the phasing of the £75m support for Rolls Royce.

COMMENT

(a) SPACE

9. The key issue is whether the benefit to the UK is sufficient to justify spending more on space in the face of all the other competing public expenditure claims. Aside from Airbus, decisions will be required in the near future on additional helicopters from Westland and on the UK contribution to the EC R&D Framework Programme. The Bide Committee have also recommended Government expenditure of £425 million over 5 years (matched by equivalent funding by industry) for a sort of Alvey II programme. Mr Channon tells me that he hopes to accommodate this in his existing provision; but it is not easy to see how, and it is undoubtedly a competing claim with space and other R&D spending.

10. Apart from general considerations (keeping up with the international space Joneses) it is not easy to construct an economic or industrial case for extra spending on space. In particular:-

(a) the returns are speculative and long-term. Mr Channon's Memorandum attempts (Annex D) to illustrate the commercial benefits gained from the UK space programme to date; and Mr Fairclough has identified (paragraph 5 of E(A)(87) 7) several groups who stand to benefit from increases of space expendi-

ture. But the case is far from convincing;

(b) It is not clear whether we have struck the right balance between the UK national programme and our contribution to the ESA. (In 1986/87, the UK national programme amounts to £33m, compared with our contribution to ESA of £80m; the corresponding figures in 1989/90, under Mr Channon's proposals, are £120m compared with £170m). If any more money is to be available, this needs to be looked at more closely in the light of the UK national interest.

(c) There is also the question of the balance between public and private sector funding of space. The private sector share of our total space expenditure is much higher than in most other countries. This is important, since total expenditure, and not just Government expenditure, which matters. (Only in Canada and the UK did the aggregate turnover of the space industry exceed the public sector space budget in 1983).

(d) The costs to the UK of participation in ESA are affected by exchange rate changes, subject to a 2 year lag. This could increase our liability. The UK, like any other Member, can withdraw from particular ESA programmes if forecast expenditure on that programme is due to exceed total provision by more than 20 per cent. But in practice such withdrawal is always difficult.

(b) AIRBUS

11. As stated above, we have not yet had time to examine these papers in detail. The main reasons stated for giving support are:

a. The project will go ahead even if BAe refuse to participate. The French and German Governments have decided in principle to support their share of the costs.

b. Our withdrawal would be criticised by our partners. You have yourself told Chancellor Kohl that it made sense to develop Airbus further to maintain an independent European capability.

c. Withdrawal would damage BAe's long-term future. They say that it would lead to closure of ~~plant~~ a design facility at either Filton or Hatfield, or Rochester, and a manufacturing plant at Broughton, Hatfield or Manchester.

12. The main argument against giving support is the poor rate of return on the project. BAe estimate it as 9.4 per cent in money, which, assuming 4 per cent inflation, only just meets the 5 per cent real return applied to low risk public sector projects. The return could be lower than this if the exchange rate is higher than the assumed $1.30 or if the Airbus fails on price or other grounds to compete with the alternative Boeing and McDonnell Douglas aircraft. Because of these poor prospects, private sector lenders have declined to finance the project. The US may also seek to cause further trouble.

13. As to the choice between launch aid and interest support:

a. Interest support substantially reduces the cash outflow in the early years (see Table in Paragraph 8 above).

b. But it means undertaking a large contingent liability of uncertain size. It could also be embarrassing in the GATT context and with the Americans.

The DTI recommend launch aid. The Treasury would prefer to leave the choice open for the time being.

Finding the Money

14. Mr Channon cannot realistically find any significant extra amounts from within his present PES. Unless, therefore, there is to be a net increase in public spending, any increased spending on

space or Airbus will have to come from other programmes. The Departments which currently contribute to our civil space programme (DTI, MoD, and DES) are unwilling to divert expenditure from their own programmes to fund additional space expenditure, although they would continue to have an interest in any expanded programme. (See Annex A for Departmental contributions in 1986/87). Mr Baker has told me that he is opposed to any substantial extra spending on space; and I am sure that Mr Younger will argue that the Defence Budget cannot provide any more. The Chief Scientific Adviser has suggested that the principal candiates for contributions are the nuclear programmes of the Department of Energy, agricultural R&D or a transfer from the Defence Budget. These are clearly worth considering in the longer term; but I fear there is little prospect of finding much in the immediate future. The only alternative would be to raid the Reserve - which the Chief Secretary will be equally keen to defend. You will, however, want to use this meeting to test the Chief Secretary's position.

NEXT STEPS

15. Mr Channon's view is that a decision by the end of March would suffice. It should therefore, be possible to bring both Space and the Airbus to E(A) for decision in the week beginning Monday, 9 March (Mr Channon will be away next week). The position on helicopters might also be clearer then (at least to the extent of whether or not MOD and/or DTI are bidding for extra funds). You may, therefore, wish to ask Mr Channon to bring his combined paper forward to E(A), revised as necessary, that week. In doing so, it may be advisable for him to consider whether he could take space forward on the basis of a much smaller addition to be present programme than he presently seeks. I doubt whether in practice the situation is as "all or nothing" as his minute claims.

HANDLING

18. You will wish to invite the Secretary of State for Trade and Industry to present his proposals. The Chief Secretary, Treasury will wish to respond. You will want the views of the Lord President and the Chancellor of the Duchy on the handling and presentation generally.

J B UNWIN

Cabinet Office
25 February 1987

ANNEX A

Provision for 1986/87 for UK's ESA contribution and the national programme

£m

	ESA Contribution	National Programme
DTI	48	12
SERC	16	12
Met Office	7	2
MoD		4
NERC		1
	71	31

CCBUP

PRIME MINISTER 25 February 1987

SPACE AND AIRBUS

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AEROSPACE : Space Policy PTZ

Paul Channon's note of 24 February.

SPACE

In my briefing note for the December E(A) (attached), I argued that BNSC had put forward an all or nothing programme and not set out a scientifically consistent menu of choices which could be tailored to the total amount that Minister's were willing to invest. Both Messrs Channon and Fairclough are still arguing the same case, the former laying greater political emphasis because of election considerations while the latter suggests a paring of the annual spend rate in 1989/90 from £302m to £250m.

Both are telling us that we have to choose between being in space 'properly' or not at all. I continue to believe that the categorisations of space expenditure have been made on the basis of what activities fit together **administratively** rather than what belong together **scientifically**. For example, the polar platform expenditure has been grouped as part of the general Columbus programme for the space station, whereas in scientific terms it is a separate entity which belongs logically with earth observation. I therefore do not accept the all-or-nothing argument but believe that the two guiding principles should be:

a. that what we do should be done well,

b. that we should build on past success which has already given us leadership.

In particular, we have clear leadership in satellite communications and the original E(A) paper identifies four significant contracts with British involvement that this area has already generated.

Conclusion and Recommendations

The space programme is imaginative and it would be good for Britain to play a strong leading role on the basis of selecting those areas where we are strong and building upon them. If the total level of expenditure proposed is unacceptably high then alternative programmes for our participation should be tailored on the basis of which topics are scientifically consistent. My earlier paper shows a table in which the overall annual total expenditures are regrouped on such a basis.

AIRBUS

The Market

The argument for this investment should begin in the market place. The A340 will be a wide-bodied four-engined aircraft with a passenger capacity of 290 and a range in excess of 7,000 nautical miles. It will need to penetrate new markets currently served by the Boeing 747 and the McDonald Douglas DC10. By contrast, the A330 is a twin-engined, wide-bodied aircraft seating between 300 and 400 passengers with a range below 5,000 nautical miles. It is the successor to the original Airbus A300 which has considerable but dwindling market share in the face of American competition.

A330

It is therefore logical to expect a reasonably good market performance from the A330 compared with the far riskier 340. For example, the DTI have estimated most likely sales of 175 units which compares with Airbus Industrie's projection of 450 units. This is a far cry from their current order book of five airlines committing to 36 units.

Financial Risk and Reward

The total development cost, excluding engines, of both aircraft is $3½bn at 1986 prices. Because of common design features either project alone would cost over $2½bn so there is certainly economy of scale in building both together. British Aerospace, which has a 20% stake in the Airbus venture, would therefore have an £840m share of the joint development cost and they are asking for 90% Government support of £750m. Once development has been achieved BAe would fund production costs. (None of these figures include the £75m launch aid requested by Rolls Royce for the A340 engine).

If both aircraft are developed and achieve aggregate sales of 610 units by the year 2006 the cash rate of return on the project would be 9.4%. After allowing for inflation this represents a real rate of return of 5.4% which is marginally above the Treasury criterion for low risk public sector projects. These projects are undoubtedly high risk, particularly because of the marketing situation with the A340. It is therefore not difficult to see why Kleinwort Benson have been unable to find any bank interested in providing private sector project finance. It is correspondingly difficult to see why Government should provide all of it.

Second Order Benefits

Airbus is a joint venture where the true return to the shareholders needs to be measured in terms of the orders which they achieve through Airbus project development. For example, British Aerospace will, if it participates in the A330/340, be given the order for the wings. The real benefit from being in Airbus can therefore be underestimated. Indeed, one wonders whether it is not

deliberately run with a cost structure which will always leave it in loss but its individual shareholders in profit!

Nevertheless, I am advised that the 9.4% return referred to above does take into account the profit element expected by BAe from the wings. Indeed, BAe will receive some 25% of the Airbus 330/340 component orders which is higher than its pro rata share in the consortium. Nevertheless, the formula structure that operates within Airbus makes it impossible for individual shareholders to identify what returns their partners are making out of their individual Airbus component orders. It is therefore possible for the French and the Germans to make significantly different real Airbus profits from ourselves. There is no hard evidence in either direction so there is a strong case in favour of tighter financial monitoring of each partner's real profits.

CONCLUSIONS AND RECOMMENDATIONS

The Airbus financial arrangements are founded on an uncommercial basis. It is unsurprising that no bank is prepared to lend money to the project without Government backed guarantees. The French and German Governments appear to be standing foursquare behind their own participating companies and there is clearly an element of steam-rollering to get Britain to fall in line by the proposed March deadline.

For the positive case, the recently launched A320 already has some 440 orders and looks as though it will achieve the target 600 orders necessary to produce a 7% return on the Government aid of £250m which it received in 1984.

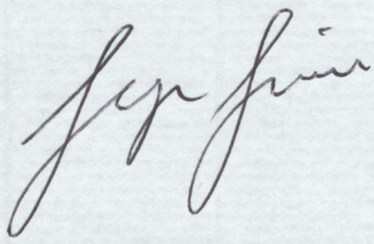
I therefore recommend:

1. That the DTI push British Aerospace very hard to find more of the total development cost from their own resources. The DTI have suggested we be prepared to offer up to 50% (£420m) with an initial proposal of 40%.

2. If this is unsuccessful, the possibility of developing the A330 alone should be examined despite the capital economies of building both aircraft together.

3. Once the principle of State aid has been accepted, it does not very much matter in Government terms whether it is provided by way of guarantee or cash injection. Mr Channon's paper recommends the latter.

4. Tougher financial monitoring arrangements need to be established.



GEORGE GUISE

APPENDIX

PRIME MINISTER 17 December 1986

BNSC - SPACE PLAN

These greatly increased expenditure proposals have been strongly attacked by the Treasury, not only on the grounds of parsimony, but because there are no tests which demonstrate value for money. Ministers have not really been shown how alternative programmes could be tailored to different resources because of the manner in which topics are linked together administratively. A proper menu of choices should be put together and I have made a rough initial attempt below.

My other main concern is management and the extent to which opportunities are missed when development approaches the commercial phase through not obtaining adequate cost recovery over the financially unproductive years. For example, it is not until the very penultimate page of the E(A) paper under Annex D that we are shown four significant satellite contracts with British involvement that our space involvement has already generated. There are other areas where the paper does not exploit its strengths. For example, the overall programme presented shows an increasing UK national programme forming some 72% of the ESA programme by 1989/90 and that is nowhere pointed out.

Alternative Groupings of Programmes

The guiding principle is that what we do should be done well. Limited resources should not be spread thinly over everything. I have therefore tried to divide the programme up into self-contained groupings:

ESA £m (cash)	86/87	87/88	88/89	89/90
Budget & Science Programme	26	31	33	37
Satellite Communications	33	37	33	34
Earth Obs. & Polar Platform	24	40	49	54
Space Station & Microgravity	2	10	19	21
Launch Systems (Excl. Hotol)	8	16	20	27
Technology	-	1	3	3
	93	135	157	176
National Programme £m (Cash)	39	66	95	126
TOTAL	132	201	252	302
HOTOL if proved	-	2	3	22

This expenditure allocation differs from Annex B of the E(A) paper which groups expenditure into administratively separate rather than scientifically separate categories. For example, the polar platform is a natural fit with the earth observation programme but has been accounted as part of the general space station expenditure under the Columbus programme because this is how it is administered. Again, participation in the US space station programme gives access to microgravity work and there is little sense in planning to do one without the other.

Value for Money and Management

Return on capital projections are a hopelessly inaccurate method of measuring the effectiveness of R&D programmes. Once the underlying plausibility for ultimate wealth creation has been established, one efficiency measure is the expenditure fraction which is actually put into the field, rather than being frittered away on committees and administration. Perhaps a proper measure of this ratio should be agreed ab initio for each research programme and regularly reported. Another useful measure is how much expenditure on other items has been willingly foregone. Note that the major spending departments are very enthusiastic about the space programme but volunteer no expenditure reallocation of their own funds.

Tough professional managment is essential when large sums are being spent at the boundary of scientific and technical knowledge. Othewise there will be delay, waste and inadequate cost recovery from the technical successes. Scientists often ride off on hobbyhorses and dismiss economic issues with either jargon or pious hope. Wittgenstein once remarked that anything which can be said at all can be said clearly and that is a very good maxim when managing scientists!

Recommendation and Key Points

The UK should play a strong role in space development by building on its initial success in areas like satellite communication. If the funding requested is not available then specific programmes should be supported in descending order of importance as shown in my table:

1. A strong positive point is that the UK national share, as a percentage of the ESA subscription, rises over the four years quite markedly from 42 to 72 per cent.

2. It is possible to be selective in space activity but it is important to distinguish those items which are separable in the scientific sense from those that are linked administratively or bureaucratically.

3. The UK is a clear leader in satellite technology. When commercial exploitation is achieved adequate prices must be charged to cover the financially unproductive years of innovation. I suspect this is an area which should not be left to the scientists.

GEORGE GUISE

Attached is an appendix on HOTOL.

HOTOL

This has not been included under launch systems because the idea of a space plane, taking off horizontally and using an atmosphere-breathing engine for the initial part of its flight, is purely conceptual. It began as a joint venture between Rolls Royce and British Aerospace and now BNSC has joined them in a two year 'Proof of Concept' study at a cost of £3m. The study will be complete by the autumn of 1988 when it should be clear whether the technological development of a space plane is an attainable goal. The project is currently a national UK project but if development appears viable it will be funded within ESA.

Any decision on HOTOL is unlikely before 1990. BNSC hopes that HOTOL will ultimately displace the French Hermes from ESA when the balance of funding would probably be 30% BNSC and 70% ESA. Hermes is a shuttle system with vertical take-off and pure rocket propulsion and therefore suffers from the traditional disadvantages and safety risks which were sadly demonstrated with Challenger.

If HOTOL is developed its main use would be the launching of satellites and manned transportation to space stations or other craft in orbit needing service. It might reduce the cost of putting satellites into low earth orbit by a factor of five and the cost of a geostationary replacement by a factor of two. The newspaper stories about ordinary passengers going to Australia for the weekend, although perhaps possible, are not the primary case for HOTOL. Total development cost has been estimated at £3 billion for a small manned capsule with a maiden flight in 1998.

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cc PS/Chancellor

COPIED TO
AEROSPACE: Space Policy PT2

FROM: CHIEF SECRETARY
DATE: 25 February 1987

PRIME MINISTER

AIRBUS LAUNCH AID AND SPACE

We will be discussing both these subjects under your chairmanship tomorrow. I need hardly emphasise what massive additional expenditure bids are involved. In the case of launch aid, British Aerospace are seeking £750 million, nearly half of it in the PES period; and Rolls-Royce are also asking for an additional £75 million. The National Space Centre are seeking to more than double their budget, with more than £300 million extra in the PES period. Both of these bids are in the aerospace sector which is already a disproportionate consumer of public funds (see Table C of the Cabinet Office paper, E(A)(87) 6). And, as the same paper reminds us, other large expenditure bids are in the wings. The problems posed for public expenditure control are therefore self-evident.

Airbus launch aid

2 When we look separately at these two bids, the position is very different. I recognise that there are arguments for continued UK participation in Airbus and therefore for paying some of BAe's development costs for the A330/340. But there are strong grounds for thinking that we should be able to keep our contribution down to relatively small sums. BAe is a private sector company with a healthy balance sheet (and the same will apply to RR after privatisation). It is in a much better position financially than either Aerospatiale or MBB and therefore needs much less funding from Government. The company would in my view be very reluctant to pull out of Airbus projects whether or not we assist them: they have a lot to gain by remaining a partner. With these considerations in mind I would favour striking an extremely tough bargain. There is a strong case for negotiating from a lower starting point than Paul Channon's paper suggests. Certainly I would take the 40 per cent figure suggested not as an opening bid but as the maximum we are prepared to contribute.

Space

3 The arguments here are very different. It is not just a question of a very large expenditure bid. There is far more doubt about the value of any addition to the space budget. None of the Departments sponsoring the Space Centre are prepared to give it other than a low priority in relation to their current programmes. Moreover doubling the space programme will dip heavily into the already shallow pool of highly skilled manpower. There will inevitably be a diversion of resources from work of higher value. The result could be that even without looking for public expenditure offsets there will be a noticable weakening of performance, for example, in the defence field - as Mr Fairclough points out, many of the principal beneficiaries of the space programme are defence contractors.

4 All this points strongly to my mind to avoiding any significant increase in space expenditure. Indeed given the concerns I have expressed about relative priorities and the effect of diverting resources from more economically productive areas, I would myself see attractions in following Mr Fairclough's logic and withdrawing from our current level of participation.

5 I am copying this minute to Willie Whitelaw, Nigel Lawson, Paul Channon and Norman Tebbit.

JM

JOHN MacGREGOR

cc G. Guise
Plup

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NOTE BY THE SECRETARY OF STATE FOR TRADE AND INDUSTRY

AIRBUS A330/340

Last October British Aerospace applied for £750m support for their participation in the proposed Airbus A330/340 projects. These projects are essentially two variants of a substantially common specification. My Department has carried out a detailed assessment of the application, assisted by Morgan Grenfell and the Ministry of Defence. To do this it was necessary to ask BAe for supplementary information, some of which was not delivered until late January. A summary assessment by DTI officials is attached.

2 On 13 February Rolls-Royce requested launch aid of up to £75m for their participation in one of the engines to be offered for the A340. No detailed application has yet been received.

TIMING

3 Airbus Industrie are pressing for a firm decision to launch the project by the time of their Board meeting on 13 March. This is for marketing reasons, particularly in relation to the A340. This aircraft is a direct competitor to the McDonnell Douglas MD11, which was launched last December. Airbus are most anxious to achieve launch by the end of March as key airlines like Lufthansa and Swissair might otherwise decide in favour of the MD11. As the MD11

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will be in service by 1990, Airbus (notably Herr Strauss, the President of its Supervisory Board) think it essential to launch the A340 now and not repeat the experience on the A320, which has lost orders to the Boeing 737 because of the delay of its launch.

4 Present indications are that neither the French nor German Governments are ready to respond by Airbus Industrie's 13 March deadline. However, the German Government is expected to give a formal go ahead (with launch aid of up to 90 per cent for MBB) at a Cabinet meeting scheduled for 28 April. The French Government, we believe, have their eyes on a formal launch announcement not later than the Paris Air Show (11-21 June). They are likely to advance launch aid to Aerospatiale of around 65-70 per cent.

CURRENT ASSESSMENT

5 On 'base case' assumptions, the A330/340 projects offer an estimated monetary return of 9.4 per cent. There are, however, a number of significant risk factors at this stage. Our two principal current concerns are:

(i) Although the launch order book for the A340 is quite encouraging, (Airbus are confident of shortly having five airline commitments to the A340 for a total of 57 orders and options), no launch orders have yet been obtained for the A330. While we still consider there is a good market for this aircraft, there is little prospect of significant early orders.

(ii) The engine situation for the A340 is less well established than it should be. The aircraft

specification has grown in size in response to market demand, and this has made the engines originally offered inadequate. International Aero Engines (IAE) in which Rolls-Royce has a 30 per cent share, is studying a possible Superfan version of the V2500. They are expected to decide in early April whether to commit to full development subject, in Rolls-Royce's case, to the outcome of their launch aid application.

The rival consortium CFM (GE/SNECMA) is similarly studying an improved version of the CFM 56-5 engine to be offered for the A340. Until the engine companies have completed these studies, and the results have been assessed, it will be difficult to assess the prospects of the A340 with a satisfactory degree of confidence.

6 Our French and German partners recognize these concerns to some extent, but appear to regard what they perceive as the wider potential benefits of going ahead as over-riding.

ROLLS-ROYCE APPLICATION

7 My Department and the MOD will subject Rolls-Royce's launch aid application to a detailed assessment as soon as it is received. It appears this may not be for some weeks. Unfortunately, the assessment is likely to take longer than usual because of the Rolls-Royce privatisation. It is important that during the period of the offer for sale (early April to mid-May) the Government should not carry forward any policy consideration which might result in decisions being taken which purchasers of the shares could claim would have altered their choice had they been publicly disclosed. This

may constrain our consideration of the Rolls-Royce launch aid application during the April/May period.

8 It may well be, therefore, that we shall not have completed our assessment of the Rolls-Royce application by the time our French and German partners start to press us for a decision on the A330/340.

9 Provided we are satisfied on other elements (including the availability of an alternative engine for the A340) we need not necessarily hold up reaching an agreement with BAe, which would enable them to join with their partners in launching the A330/340, while we complete our assessment of the Rolls-Royce application. On the other hand, once the aircraft are launched, there will be pressure on us to ensure that Rolls-Royce can play its part in offering one of the engine options. Domestically there will also be some pressure to reinforce what will by then, I believe, have been a successful privatisation.

10 The Superfan engine is being developed specially for the A340, although it may be used for Boeing's 7J7 rival to the A320, which is scheduled for service in 1992. It would theoretically be possible to approve launch aid for the Superfan but not for the A330/A340, but this would be a very surprising decision to take as the economics of the engine depend on its use in the A340.

BRITISH AEROSPACE APPLICATION

11 In my view, if the A330/340 go ahead, it is in the national interest that BAe should participate in the projects. The relatively low rate of return is, I believe, outweighed by wider factors. Airbus Industrie has become

the most conspicuous example of European industrial co-operation in competition against the industrial conglomerates of the USA. With the A300, A310, and A320 Airbus is now established as a recognized force in world civil aviation. After a faltering start in the 1970's, the UK is now accepted as a full partner in the enterprise.

12 This does not mean we should not continue to express our current concerns to our partners and hope to influence their decisions. But in the end, I believe, we must accept the responsibilities of partnership.

13 BAe have based their application for support not on the economics of the projects in isolation but also on the impact estimated non-recurring launch costs of £840m (at outturn prices) plus interest charges would have on the company's overall financial health. In BAe's submission, the company already has £1bn of assets tied up in civil aircraft compared to shareholders' funds of £1.2bn. In BAe's view the additional risks if they undertook the A330/340 would carry their exposure beyond the level the Board could responsibly accept.

EFFECTS OF WITHDRAWING FROM A330/A340

14 On European Partners: The UK's major partners are France and Germany. Our minor partners are Spain, the Netherlands and Belgium. National commitment to, and pride in, Airbus is very strong in all these countries. You will recall the strong support in principle for the A330/A340 projects expressed by Chancellor Kohl, President Mitterrand and Mr Chirac at the summit meetings last year. They would regard it as unthinkable for the UK to withdraw from the A330/A340, thus letting down the other partners, a few weeks

before the launching of the projects. BAe's withdrawal would probably set back the projects by at least a year, and greatly weaken the consortium in world markets. It would be seen as running counter to the Principles of Co-operation agreed between the Airbus Partner Governments in 1978 under which HMG fully support BAe's participation in AI.

15 The German Cabinet are likely to decide formally to give launch aid to their industry on 28 April. The French decision may be later, but could be taken sooner following the close personal interest of M. Chirac, who was present at the roll-out of the A320 on 14 February. President Mitterrand's brother is in charge of Aerospatiale, the French partner in Airbus.

16 On British Aerospace and UK Equipment Suppliers:
Total employment on the A330/A340 programme is expected to reach a peak around 1994/95 with about 6,500 jobs at BAe and an estimated 3,500 at UK equipment suppliers.

17 Non-participation in the programme would lead to some 5,000 job losses within BAe. These job losses would begin in 1987 and reach a peak in 1992. In the event of non-participation, BAe would not be able to replace this work with contracts for US aircraft manufacturers on competing aircraft because of contractual commitments to Airbus.

18 BAe would have to close one major manufacturing site. This would probably be either Broughton (North Wales) or Hatfield or Manchester. In addition, there would be a reduction of 750 jobs among design staff, and the closure (probably in 1987) of one of the Company's three Design Centres at Filton (near Bristol), Hatfield or Manchester.

The effect of non-participation on employment at UK equipment suppliers is speculative, but the likelihood is that only a small proportion of the estimated 3,500 jobs at UK suppliers would be saved through contracts with other AI partners.

PRIVATE SECTOR FINANCE

19 BAe and Kleinwort Benson have made exhaustive efforts to find private sector institutions willing to provide some genuine risk finance for A330/A340, but have failed. DTI and Treasury (advised by Morgan Grenfell) are satisfied that the search has been thorough. Banks are only willing to lend against guarantees.

20 The German Government is expected to provide 90 per cent of the necessary development finance for their industry to participate, with the rest of the finance guaranteed. They are trying this time to avoid giving guarantees for production work, which HMG has never contemplated. The French Government are likely to provide launch aid of around 65-70 per cent for their industry, and to provide guarantees for the rest of the finance.

21 As a way of spreading the risk (and also to obtain other potential benefits) we have explored the possibility of a collaboration between Airbus Industrie and McDonnell Douglas, but this has not proved practicable.

GOVERNMENT SUPPORT

22 I have therefore reluctantly concluded that if BAe are to participate effectively in the A330/340, it will be necessary for the Government to share the risk with the company to a certain extent. BAe have said they are

prepared to take the risk on the production finance required (some £280m up to 1993), and on £90m out of the development costs of £840m (a little over 10 per cent). This leaves £750m (nearly 90 per cent of estimated development costs) on which, in BAe's view, the Government should take the risk.

23 I do not believe such a substantial Government involvement would be justified. However, on the basis of detailed advice, including the advice of Morgan Grenfell, I have concluded that it would be reasonable to offer to BAe that the Government would share the risk up to a figure within the range £336-420m. This range represents 40-50 per cent of BAe's estimated development costs. My advisers consider 50 per cent would be justified, but I would envisage an "opening bid" of 40 per cent.

24 BAe have formally said they cannot accept less than 90 per cent. Informally, however, there have been certain indications that they would be prepared to consider 65-70 per cent, and I would hope to persuade them to move further.

MECHANISM OF SUPPORT

25 We have explored two possible mechanisms. The first is a traditional launch aid scheme, under which any support offered would be a charge on public expenditure. The second is a guarantee and interest support scheme. Under this, the Government would guarantee BAe's commercial borrowing up to the agreed figure, and would also advance the finance costs on this borrowing. Only the latter would be a charge on public expenditure in the early years. However, there would be a contingent liability under the guarantee to repay BAe's commercial borrowing should sales fall short.

26 The cost to HMG of providing launch aid of 40 per cent to British Aerospace would be £336 million, spread over the years 1987-88 to 1991-92. The cost of the alternative method of providing Government guarantees and interest support would be some £203 million in the period 1987-88 to 1996-97. A table showing the comparative expenditure and receipts under these two methods up to the year 2006-2007 is at Annex 1.

27 Under both schemes the Government would receive its return via a mixture of fixed repayments and levies on sales. Under a launch aid scheme, I would aim to provide for equal rates of return of 9.4 per cent to the Government and BAe (compared to the 7 per cent target rate of return to the Government on the A320). On a similar levy profile, the return to the Government under the guarantee scheme would be less (about 8 per cent) because of the need to remunerate the financial intermediaries.

28 I would hope also to negotiate a provision for accelerated returns to the Government should BAe's profits exceed predetermined levels.

29 The guarantee route has advantages in cash flow terms in the early years. However it has the usual disadvantages associated with contingent liabilities and interest support schemes. It could also cause greater offence to the Americans in the context of the GATT than launch aid, although I would contend that neither scheme is inconsistent with our GATT obligations.

30 If colleagues decided in principle that some support should be given to BAe, I would wish to consult Nigel Lawson about the balance of advantage between these two mechanisms.

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I would also need to consult the Law Officers about the guarantee scheme, although my provisional legal advice is that it is within existing statutory powers. On balance my own preference at this stage would be against the guarantee and interest support scheme.

A320

31 The Airbus A320, in which BAe is already participating with launch aid of £250 million, is proving a tremendous success, and 439 had been sold by the time of the first flight on 22 February. HMG is confidently expected to achieve over the first 600 sales the 7 per cent monetary rate of return which was agreed with BAe in 1984. This sort of success has never previously been achieved with civil aircraft projects. At Annex 2 is a table showing projected Government receipts over the next five years from the A320, alongside the cost of giving 40 per cent support for the A330/340. In terms of year-to-year cash flow, receipts from the A320 would begin to outweigh expenditure on support for the A330/340 by 1991/1992 (or earlier if we adopted the interest support route).

US OPPOSITION

32 The US Government have tried to apply political pressure to hinder the launch of the A330/A340, but European Governments and the EC Commission have united strongly to resist this pressure. It can be expected to intensify if the A340 (the direct competitor of the MD11) is launched. The US have requested a special session of the GATT Aircraft Committee in mid-March. In preparation for this, Airbus partner countries and the Commission will be co-ordinating their position. It is hoped that the US will not take any

unilateral action against Airbus such as anti-dumping or countervailing duties, as it would be difficult for European countries to retaliate in kind because of their dependence on the Boeing 747. However, the scope for retaliation will be considered.

IMPLICATIONS FOR JAPAN

33 Japan has been trying in recent years to break into the world aerospace market as a manufacturer, but so far with little success. If the A330/A340 were launched, with British participation, this might be a factor in causing Japan to collaborate in future with Airbus rather than with Boeing. Japan is already involved in the International Aero Engines V2500 engine, and would similarly be involved in the V2500 Superfan.

PUBLIC EXPENDITURE

34 Although the A330/340 projects have been under discussion for some years, in accordance with established Treasury procedures no budgetary provision has been made for them in my Department's PES projections. In these circumstances it would be quite impossible for my Department to accommodate any agreed support within its PES baselines. Indeed I made clear to John MacGregor some months agao that this would simply not be possible within the financial constraints applied to the DTI's budget. This contrasts with the situation in France and Germany, where provisions have been made and it is now simply a question of deciding the conditions for their release.

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CONCLUSION

35 My conclusions are:

(i) that I should be given negotiating authority to offer to BAe that the Government would share their risks on the A330/340 up to a figure within the £336-420m (40-50 per cent) range, subject to tactical considerations. I would consult Nigel Lawson about the mechanism of support, and would of course keep him in close touch with the progress of discussions with BAe;

(ii) that I should make clear that this offer is conditional on our current concerns about the projects being clarified. In particular, we should press BAe strongly to agree to a full range of monitoring arrangements for the project (see paragraphs 62-3 of the attached assessment);

(iii) that my Department and MOD(PE) should process the application by Rolls-Royce for launch aid as quickly as possible after it is received; but that we should recognize this process may not be complete before June.

P C

DEPARTMENT OF TRADE AND INDUSTRY

24 February 1987

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ANNEX 1

EXPENDITURE AND RECEIPTS ON
40% FINANCIAL ASSISTANCE (£M)

FINANCIAL YEARS	LAUNCH AID	INTEREST SUPPORT
1987-88	(45)	(2)
1988-89	(80)	(9)
1989-90	(78)	(16)
1990-91	(75)	(24)
1991-92	(58)	(31)
1992-93	Nil	(34)
1993-94	29	(32)
1994-95	101	(26)
1995-96	62	(18)
1996-97	71	(11)
1997-98	77	0
1998-99	73	73
1999-2000	60	60
2000-01	49	49
2001-02	51	51
2002-03	50	50
2003-04	43	43
2004-05	42	42
2005-06	33	33
2006-07	7	7
Total Gross Govt. Expenditure	(336)	(203)
Total receipts to Government	748	408
Net return to Government:	412	205

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ANNEX 2

ILLUSTRATIVE COMPARISON OF PUBLIC EXPENDITURE POSITION
1987/88 - 1991/92

Each column assumes support provided on £336m

Column (1) assumes launch aid payable against design and development costs only.

Column (2) assumes £336m of commercial borrowing by BAe is guaranteed, and the related finance charges are advanced by HMG.

Column (3) shows the launch aid payments for the A320 and in later years, expected receipts under the launch aid contract.

£M

	Launch Aid for A330/A340	Interest Support	A320 Payments/(Receipts)
1987/88	45	2	44
1988/89	80	9	-
1989/90	78	16	(12)
1990/91	75	24	(50)
1991/92	58	31	(72)
	336	82	(90)

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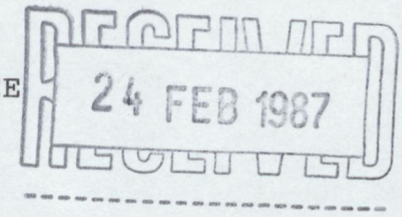

Airbus A330/340

REQUEST BY BRITISH AEROSPACE AND ROLLS-ROYCE

1 British Aerospace (BAe) have asked for £750m support, in the form of either launch aid or guarantee and interest support, for their participation in the proposed A330 and A340 projects. This request has been assessed by the DTI, assisted by Morgan Grenfell, and the Ministry of Defence.

2 Rolls-Royce (RR) have requested launch aid up to £75m to support their participation in the V2500 Superfan project to power the A340. However, no details have been received and this paper deals only with BAe's request.

Timing

3 Airbus Industrie have asked their four partner companies (BAe, Aerospatiale (France), MBB (Germany) and CASA (Spain)) to be ready to agree formal launch of the projects on 13 March. BAe are accordingly requesting a decision on their application for support before that date.

THE PROJECTS

4 BAe is a partner in Airbus Industrie which produces the A300 and A310 wide-bodied airliners, and is developing the A320 which has already achieved some 450 orders and options. The A320 was "rolled out" in Toulouse on 14 February in the presence of the Prince and Princess of Wales. Its first flight will take place within a few days and it is due to enter service in 1988.

Overall Strategy

5 Airbus Industrie's strategy is:

i to maintain their position in the large capacity, medium haul market sector.

ii to extend their market penetration into the long haul sector and attack the present Boeing monopoly in this sector.

iii to achieve this by developing and producing a single basic design of aircraft in two variants, thus achieving substantial economies.

A330 and A340

6 The A330 and A340 would have substantially common airframes (including wings supplied by BAe) and equipments, but different engines.

7 The A330 is a wide-bodied, twin engined airliner, seating some 300 (or up to 400 depending on configuration) with a range of up to 5000 nautical miles. It is basically the successor to the original A300 Airbus which has achieved considerable success in terms of market share but is now subject to fierce competition from newer US aircraft. The engines for the A330 will be the largest available civil turbofans, the Pratt and Whitney 4000 or the General Electric CF680C2. The Rolls-Royce RB211 is too small in its present versions.

8 The A340 is a wide-bodied four-engined aircraft, seating up to 290 and with a very long range (7000 nautical miles plus). Whereas the A330 is aimed at a traditional market for Airbus, the A340 is a new departure aimed at capturing a market for long-haul operation on routes where the traffic is insufficiently dense to justify a Boeing 747. The A340 is thus aimed at attacking the B747's current monopoly position in its class. The financial implications of subjecting Boeing to this competition are an important part of the business case for the project.

9 The engines originally proposed for the A340 were either the American/French CFM56 or the IAE V2500, in which Rolls-Royce have a 30% share. The V2500 is the engine currently under development (with launch aid) for the A320. Because of growth in size of the aircraft design, these engines are now inadequate. Recently Rolls-Royce and Pratt and Whitney (the other major partner in IAE) have announced that they are studying a Superfan version of the V2500. This is the project for which Rolls-Royce are applying for launch aid. They are likely to decide whether to commit to development of the project in the first half of April, subject to the outcome of their launch aid application.

10 The CFM consortium is similarly working on an improved version of the CFM 56-5.

The Market

11 The DTI considers the total market for aircraft of the A330 and A340 types over the period 1992-2005 lies in the following ranges, which take account of a range of assumptions on world GDP growth:

A330	A340
1075-1350	125-550

999-80

The considerable width of the total market range for the A340 type is due, in this case, to alternative assumptions also being taken about the extent to which such aircraft will match the operating costs of the B747. This factor is seen as critical to the success of any project in this sector of the market.

The Competition

12 Competition to the A330 would come principally from:

i	McDonnell Douglas MD11	:	A tri-jet derivative of the DC-10, in full development since December 1986. In its medium range version would compete against A330.
ii	Boeing 767	:	In service since 1983. Smaller than A330 but capable of further development.

13 The competitors to the A340 would principally be:

i	MD11	:	Long range version will have similar capacity and range to latest proposed version of A340. Passenger cabin of MD11 will be wider than A340. But operating economics of A340 should be superior.

ii Boeing 747 : Present versions are significantly larger than A340 (400 + seats). Has an existing monopoly in this market sector. Boeing may develop new short-bodied version.

14 Market Share

A330 : The DTI considers a market penetration of 410 aircraft has a 75% probability of being exceeded. Most likely figure perhaps around 500.

A340 : DTI consider market penetration of 140 has a 75% probability of being exceeded, provided the aircraft can match the operating costs of the 747, and meet its other performance targets. Most likely sales figure perhaps 175.

Aggregrate Sales : In DTI view, a figure of 550 has a 75% probability of being exceeded. Most likely figure perhaps 675. But Airbus Industrie say over 1000, including 450 A.340's.

Present Market Situation

15 Airbus Industrie have obtained, or are highly confident of obtaining very shortly, five airline commitments to the A340, covering 36 firm orders plus 21 options. No commitments have yet been obtained for the A330.

16 Airbus Industrie are engaged in a market battle to obtain orders for the A340 against competition from the MD11, which was launched in December 1986, and is claimed by McDonnell Douglas (almost certainly with some exaggeration) to have obtained some 90 orders and options. Airbus Industrie consider it essential to launch the A340 by mid-March in order to match this competition. Specifically, Airbus Industrie hope that a formal launch would capture a prestigious order from Swissair, who are currently examining rival bids and are expected to take a decision on 17 March.

Cost

17 The total estimated development cost (excluding engines) of the A330/340 combined is some $3½ bn at 1986 prices. This compares to an estimated development cost of either project on its own of over $2½ bn.

18 BAe's share is estimated at £840m at outturn prices. In addition BAe would need to finance their share of production. BAe estimate their exposure would rise to a maximum of around £1120 m in 1994 in the absence of risk sharing with any other party. BAe's request for £750 m support represents 67% of their total exposure or just under 90% of their development costs.

19 Rolls-Royce estimate their development cost on the V2500 Superfan at £150 m. They are requesting support up to 50% (£75 m).

Selling Price

20 The target selling price for the A330 and 340 will be in the $60-70 m range (1986 prices), according to version.

Rate of Return

21 Assuming 610 aggregate sales of the two projects up to 2006,(a figure half way betwen the DTI "most likely" figure of 675 and the "75% confidence" figure of 550) and an average exchange rate of £1 = $1.30, BAe estimate the rate of return on the project to be 9.4% in monetary terms. Assuming inflation of 4%, this represents a real rate of return marginally above the 5% Treasury criterion applied to low risk public sector projects.

RISKS

22 These projects, however, are undoubtedly high risk in certain respects. DTI officials assess the effect on the rate of return of a 10% increase in key assumptions to be as follows:

10% increase in:	Change in outturn rate of return pa from 9.4%
Sales volume	+ 1.0
Airframe price	+ 4.6
Production man-hours	- 1.6
Non-recurring cost	- 0.6
Exchange rate	- 3.6

Sales

23 The most likely combined sales figure of 675 for the two projects is consistent with Airbus Industrie's historic market

penetration and DTI officials consider it to be reasonably robust, provided the target performance of the aircraft can be achieved. In the large capacity sector of the market, which both A330 and A340 would address, there does not appear to be an unacceptable risk that a major technological development in aero-engines would kill the projects in the market place. (The new so called "propfan" engines now under development are targetted at smaller aircraft).

24 The division of sales between the two projects is more difficult to predict. To some extent a shortfall on one may be compensated by an improvement on the other. We believe the greater sales will be on the A330. This will be the largest twin offered in the market and should have substantial operating cost advantages over its competitors. However, while we consider the overall sales prospects of the A330 are good, it is inevitably a matter of concern that no significant orders are immediately in prospect.

25 The A340 will be operating in a more limited and more competitive market sector. In DTI officials' view success will depend critically on how near the aircraft can get to matching the operating costs of the Boeing 747.

Price

26 The above table shows the return on the project to be more sensitive to the selling price than any other single factor. Boeing and McDonnell Douglas can be expected to compete very aggressively on price. It is critical to the achievement of target operating costs on the A340 that the price should undercut the Boeing 747-200 by $10M, and the -300 by $20m. On present projections this looks achievable and the rate of return

calculations build in a substantial margin (the 747's are currently selling in the $95-106m range). It is nevertheless possible we have underestimated Boeing's ability to cut the 747 price. But:

i Boeing's resources are not unlimited. To maintain a price cut of, say, $40m on 747's would seriously dent Boeing's profitability.

ii To the extent that Boeing reduce the 747 price, they will lessen their ability to cross-subsidise other products in competition with Airbus (eg the 737 and 757). This could help Airbus achieve better prices on the A320.

iii There would also be a benefit to European airlines (including BA) who might be considering further 747 orders.

Production Costs and Non-Recurring Costs

27 In general, MOD/DTI officials consider BAe's cost estimates are well-founded and subject to acceptable levels of risk. BAe's record on the A320 has been good in this respect.

Exchange Risk

28 The table shows the relatively high sensitivity of the rate of return to exchange rate changes. This is a perennial feature of the aircraft industry, where prices are generally dollar based. Even the US manufacturers are not wholly shielded from these risks as their own programmes become increasingly internationalised.

The Engine Situation

29 For the A330 the engine situation appears satisfactory. The requirement is within the capability of the PW4000 or the GE CF680C2 with relatively minor development. It is unfortunate that the RB211-524 does not look like meeting the thrust requirement. Rolls-Royce, however, are hopeful of persuading McDonnell Douglas to offer the engine as an option on the MD11.

30 For the A340, the present position is considerably less satisfactory. This project has a history of growth in size to meet perceived market demand. At the A.340's proposed size and weight, MOD/DTI officials judged the existing versions of the V2500 and CFM56-5 engines to be at best marginal, and to offer an unacceptably small growth margin: The existing V.2500 has now in fact been withdrawn from offer by the manufacturers International Aero Engines (IAE), makers of the V2500, have instead conditionally offered to Airbus Industrie to develop a V2500 Superfan engine which would give substantially improved performance. IAE (in which Rolls-Royce have a 30% stake) are also hopeful that Boeing will select this engine for the proposed 7J7 aircraft, although at present it is only one of a number of possibilities under consideration by Boeing.

31 This is the project for which Rolls-Royce intend to apply for launch aid. At this stage, discussions are still going on between the IAE partners (principally Pratt and Whitney and Rolls-Royce) to define the proposed engine, in the light of which they will decide whether to proceed with the programme. Until this process is complete (the current target is early April) it will be impossible to carry out a detailed assessment of the programme. DTI/MOD officials are, however, in close contact with Rolls-Royce and we are already aware of at least three areas of potential

technical risk. In addition we are concerned at the level of guarantees, both on performance and delivery date, that have been conditionally offered to Airbus Industrie.

32 The rival consortium CFM (GE/SNECMA) is known to be working on a competitive project to the V2500 superfan. Very little hard information is available on this project. It is a fair asumption that it is at a similar preliminary study stage to the V2500 Superfan project.

33 There is some concern that, with the continued growth in size and weight of the A340, even these new engines would not offer sufficient growth potential. In that event, it may be possible to persuade Airbus Industrie to look more seriously than they have so far been prepared to do at using the RB211-535 (and possibly the rival Pratt and Whitney 2037). These are larger, heavier engines, but should cope easily with the thrust requirement.

34 It is not unusual for there to be some uncertanties surrounding the engines for a new aircraft at this stage. But in case of the V2500 Superfan the degree of uncertainty, the tightness of the timetable, and the extent of the proposed guarantees, give rise to considerable concern at official level in the MOD/DTI.

US Retaliation

35 In recent months another risk has arisen in the form of US threats to take retaliatory trade measures against Airbus if the projects go ahead with Governmental support which, in the American view, may contravene the GATT. This threat is directed particularly at the A340 because of the direct competition between this aircraft and the MD11. If the Americans were to apply

countervailing duties, the competitive position of Airbus in the US would be seriously damaged.

36 The situation on this is somewhat fluid. At recent meetings in European capitals, the Americans met with a robust response at the political level. They are now considering their position. Preliminary indications are they do not intend to seek an immediate confrontation. However if the Airbus projects are launched with government support, we expect renewed pressure from the US.

Airbus Industrie

37 In 1985 considerable changes were made to the top management at Airbus Industrie, including the introduction of a new (British) Finance Director. The new management has proved more cost-conscious and professional than the old. While the structure of Airbus Industrie (a partnership under French law) still leaves much to be desired, we assess the risks of associating with this body to be less than previously. It is encouraging that the French Government has recently signalled a willingness to examine further improvements.

NATIONAL INTEREST

38 Notwithstanding the relatively low rate of return, there are reasons why Ministers might consider that it is in the national interest that BAe should participate in these projects, provided finance can be arranged on an acceptable basis.

39 We believe the projects will go ahead in any event, with financial support from the French and German Governments. It is conceivable that, if BAe refused to participate on a risk-sharing

basis (because HMG had refused support) the company would be contracted by the consortium on a non-risk-sharing basis to develop and provide wings for the projects. This was what happened in 1969 when a previous Briitsh Government declined to give launch aid for the A.300. However, we believe BAe's chances of achieving such a position again are virtually nil. The industrial situation has changed since 1969, and there are now other companies (eg MBB of Germany) who would be willing and able to take on the work. The "political/industrial" situation has also changed. Since 1979 BAe have again been full risk-sharing partners in Airbus, with Governmental support. The Airbus enterprise has developed from a single project collaboration into the most conspicuous example of European civil industrial cooperation.The A320 has already achieved considerable sales success. Airbus is seen by the French and German governments as a continuing enterprise embracing a growing family of products. If the UK now tried to withdraw from its full partnership position, there is little doubt that at Governmental as well as industrial level, our partners would seek means to exclude BAe from participation altogether. We think, therefore, that the possibility of pulling off the 1969 trick a second time must be dismissed from consideration.

Wider Considerations

40 The developments in the "political/industrial" scene in the past 15 years also provide positive reasons for concluding that it is in the national interest that BAe should participate in the projects as full partners. Although Airbus is not strictly an EC venture, it has come to be regarded as a major European industrial partnership and a manifestation of the growing ability of European industry to compete with America. As such (and despite current US complaints about specific trading practices), Airbus is firmly

within the principles underlying NATO and the fundamental philosophies of the Western alliance.

41 British participation in Airbus is therefore, we believe, a matter of some political importance to HMG both in relation to our European partners and more widely. Conversely, non-participation would entail certain penalties in terms of some of HMG's basic political tenets.

42 There are contrary arguments. The main one is that it does the UK no good to be seen to be continuing to put resources into prestige projects with a poor rate of return. This can be seen as the UK further delaying the painful process of adjustment to its appropriate world position.

Industrial Implications

43 For BAe itself, non-participation in the projects would almost certainly make it impossible for the company to participate in any future Airbus project. BAe's prospects of continuing to be in the large civil transport business would then depend on their ability to negotiate collaborative arrangements with US companies. The company would be in a weak negotiating position (and would be debarred by contractual obligations to Airbus from collaborating on any direct competitor to an existing Airbus project). There is therefore a risk that non-participation in the projects could signal the permanent withdrawal of BAe from the large civil transport business. The implications of this for BAe's remaining business are uncertain:

i) It is not clear how BAe's position on existing Airbus projects (including the A.320) would be affected. We believe there is a reasonable chance that for practical reasons BAe's existing contracts would not be affected.

But the company's influence within the consortium would probably diminish. This would be a matter of concern, because BAe would remain risk-sharing partners and the plain fact is the French and Germans have a different attitude to risk than we do.

ii) The effect on BAe's other civil business (146, ATP, Jetstream etc) is also uncertain. BAe consider it would be adverse, because their overall marketing effort depends on the ability to offer a complete range. There is probably some truth in this, but we would not put much weight on it.

iii) The effect on the company as a whole would be significant. On present trends, the value of business placed with BAe by the MoD is likely to diminish in coming years, irrespective of the decision on the EFA. All the major aerospace companies aim to take advantage of alternating cycles in their military and civil businesses. BAe's present corporate forecasts assume a relative expansion of their civil business over the next two decades. Withdrawal from Airbus would require a major adjustment to this strategy. Essentially BAe would begin to face a similar problem to Westland though, fortunately, with greater resources to meet it.

Plant Closure

44 BAe have said non-participation in the projects would lead to the closure of either the Filton or Chester sites (the latter is in fact in N. Wales). There is no reason to doubt that this would be the case.

Equipment Companies

45 There is no doubt that if BAe do not participate in the projects as risk-sharing partners, UK equipment companies will be at a severe disadvantage in winning contracts on the projects. The value of equipments on each production aircraft can be expected to be around $12-15M at 1986 prices. With BAe participation, UK equipment companies would expect to pick up $1½-2½M of that: without, probably around a quarter of those figures. Since Airbus is increasingly regarded as the domestic launch base for the civil products of European equipment companies, the exports of our firms would also be damaged.

Rolls-Royce

46 By contrast, Rolls-Royce's position is unlikely to be much affected by BAe non-participation in the projects. There is a risk that, if the UK withdraws from Airbus, the French would try to exclude the V.2500 engine from consideration for the A.340 in favour of their own (in part) CFM 56. We would judge, however, that they would not do this in the overall commercial interests of the project, although they might in various ways give more favourable treatment to the CFM engine if we were not there to protect RR's interests.

FINANCE

47 BAe have proposed to provide at their own risk all the production finance required (some £280M.) plus somewhat over 10% of the development finance (£90M.), a total of £370M. While BAe would also be content to raise the rest of the required development finance (£750M.) from their own or commercial sources,

they have stated that they cannot accept the risk attached to this sum consistently with their responsibilities to shareholders. They have proposed that the Government should assume this risk by means of one of two routes:

i) launch aid; or

ii) a guarantee of commercial borrowing, coupled with direct Government financing of the interest costs of such borrowing.

Private Sector Risk Funding

48 Working through BAe and our advisers, Morgan Grenfell, we have explored further whether private sector risk capital could be made available to fund any part of the required £750M. A number of banks, including overseas banks, have been approached, but with negative result. All the banks insisted that the projects were too long term and high risk for themto contemplate involving themselves in except under fully guaranteed conditions. Our reluctant conclusion is that this route is not available.

Ways of Reducing BAe's development costs

49 We have explored three main ways in which BAe's costs might be reduced:

i) Bring in another partner: Exploratory talks have been held with McDonnell Douglas at the UK's initiative. Unfortunately it has proved impossible to work out a deal, and MDD have now launched the MD11.

ii) Drop the A.340. Because of the substantial commonality of the wing, the saving of development cost to BAe would be comparatively small, though there would be a saving on provision of flight test wing sets, tooling and related items. Total cash flow savings probably up to £120M (this figure would be subject to confirmation by BAe although it is based on earlier discussion with them).

Unless the need to find such a cashflow saving became critical, we would not recommend this course. BAe consider the A.330 a non-viable project on its own. Although the A.340 is the more controversial project of the two, we believe it will do well to achieve more than 200 sales in a very competitive market. But it is those additional sales, achieved at comparatively low additional cost, that lift the aggregate rate of return, if not to attractive levels, at least to viability. In addition the A.340, by attacking the B.747 monopoly, is expected to bring financial benefit to Airbus beyond its own sales revenues.

iii) Reduce BAe's workshare: BAe are bidding for a workshare of around 25% on the project airframes. The company could reduce this bid and give some work away, probably to the Germans.

For technical reasons, there are only limited practical options available without imposing unacceptable cost penalties on the whole project. But BAe's costs could be reduced by perhaps around £30-40M by accepting a lower work-share (this figure also subject to confirmation by BAe). Again, we would

not recommend this unless the need to find such a saving in the financing burden became critical.

Views of DTI and Morgan Grenfell

50 Both DTI officials and Morgan Grenfell consider BAe are unjustified in insisting that they can only take the risk on £370M and not on any of the £750M remaining cost. In the DTI's view, agreement with BAe ought to be feasible on the basis of launch aid of £336M (40% of BAe's development cost) provided the support is allocated against design and development cost. Levies and fixed returns would be designed to equalise the return to HMG and BAe at 9.4%. (But note this leaves out of consideration any subsidy element in official support for A.330/340 export finance in future years). Such a level of support would appear likely to protect BAe's future profits against unreasonable deterioration during the development phase of the projects. However, because of the impact of this level of support on gearing, the Department considers that support up to £420M (50% of development costs) could be justified, payable in respect of all launch costs. In this event, the Department considers that a faster and more risk-free schedule of repayments by BAe should be requested.

51 Morgan Grenfell also take the view that the £420M (50%) level would be justified.

Launch Aid Route

52 Under this route, the full amount of whatever support might be agreed would be a charge on public expenditure. The return would be via levies on sales, except that we would hope to negotiate that at least 20% of the advance to BAe was repayable on a fixed schedule, irrespective of sales, thus very substantially

reducing the Government's risk on that element. Subject to negotiation with BAe, the launch aid would be payable over the period 1987/88 to 1991/2, assuming launch aid of £336M payable against design and development costs.

Guarantee Route

53 Under this route, the agreed level of finance would be raised commercially and would not be a charge on public expenditure. However the agreed amount would be guaranteed and, if sales fell short of the level necessary to provide sufficient levies to repay the commercial borrowing, or the project were unexpectedly cancelled, the resulting payments under the guarantee would be a public expenditure charge. In addition the interest costs of the borrowed finance would, under the scheme proposed, be paid by HMG and would be a charge on public expenditure. In consideration for the guarantee and interest support, the Government would receive a fixed repayment and levies on sales as under the launch aid route. The Government's cash outflow under this route might, subject to negotiation with BAe, be restricted to £82M over the period 1987/8 to 1991/92, and might peak at £203M in 1997. However the Government's return on the project would be reduced under this route because of the need to remunerate the financial intermediary.

Tables

54 The table at Annex A sets out a comparison of the Government's possible cash position over the period 1987/8 to 1991/92 under the launch aid and guarantee routes, on the assumption that support to the value of £336M is given either by launch aid or by guarantee. The figures must be taken as

illustrative only, since the exact figures would depend on the detailed negotiation with BAe of a large number of variables.

55 The figures assume a degree of front-end loading of support, though not to the same extent as was done for the A.320. There is likely to be some room for trade-off between amount and timing of support.

56 For convenience, the Government's position on the A.320 is also shown on the table. 1987/8 will see the final launch aid payment on the A.320 out of the agreed £250M commitment. By 1991/92 £90M cash inflow will have been received from fixed repayments and levies on sales. A high level of confidence can be placed on these figures; indeed they have been calculated on a conservative basis for 1990/91 and 1991/92 and may well be exceeded.

57 Taking the A.320 into account, there would be a substantial net cash inflow on the Government's overall Airbus account in 1990/1 and 1991/2 if the interest support route were used for the A.330/340. If the launch aid route were used, the Government's overall cash position would approximately break even in 1991/92.

58 Annex B shows a more detailed scheme of how a support scheme for £336M might be applied. Again, these figures should be taken as illustrative only.

Comparison of Launch Aid and Guarantee Routes

59 The Government's risk would be the same under either route. But the guarantee and interest support route has the advantage over the launch aid route that the the cash outflow from the Exchequer is substantially less in the earlier years.

60 The disadvantages of the guarantee and interest support route are:

i) As a general policy, the Government tries to avoid undertaking contingent liabilities (although in this case they would be precisely quantified).

ii) To the extent that the commercial interest rate charged by the guaranteed lenders exceeded the rate at which the Government itself could borrow to finance launch aid, there would be a financial penalty to the Government to be set against the cash flow benefit.

iii) Since the interest rate might vary, the Government's forward public expenditure commitment would be less certain than under a launch aid scheme expressed as fixed amounts (not a strong point, since the Government's borrowing rate to finance launch aid would also be subject to variation). However, BAe should be able to fix a substantial part of interest costs through financial facilities now available.

iv) More important, if the programme were subject to delay and interest charges increased, the Government would, under the scheme as proposed, have to meet the increased charges. This is not the case under a launch aid scheme expressed as fixed amounts. BAe may be prepared to introduce a cap on the level of interest supported under the scheme.

v) The guarantee and the fact that the commercial interest payments were being officially funded would need to be disclosed. Although we would contend such funding is not inconsistent with the GATT such disclosure would be unhelpful in the context of the current discussions with the Americans. This point is one of some concern.

61 The choice between the two routes is a fine one, and the Treasury will have a view as well as the DTI.

PROVISION OF FINANCIAL INFORMATION ON AIRBUS

62. There has been criticism in some quarters that Airbus Industrie does not publish an annual report and accounts. This is true. However, Airbus Industrie does produce annual profit and loss accounts, and these are properly audited. In addition, Airbus partner governments receive copies of these accounts as well as other information from Airbus Industrie on its financial results. As a Groupement d'Interet Economique established under French law Airbus is not required to publish accounts, and this situation cannot be changed. Moreover, it would not be in the interests of AI or BAe to have detailed information published which would be of great value to their international competitors, who do not publish financial information about programmes of theirs which compete with Airbus.

63. The financial consequences for British Aerospace of their participation in the Airbus programmes and partnership are, of course, reflected in the Company's published annual accounts. The same is true of BAe's partners in the other countries. In the course of appraising BAe's launch aid application, officials have obtained detailed forecasts of BAe's profits

on the A320 and A330/A340 programmes up to the year 2000, and the financial assessment of the project has taken account of these. However, officials have recommended that DTI Ministers should seek, as a condition of launch aid, a strong monitoring package which, among other things, would require BAe to provide the Department annually with a breakdown of their Airbus results, programme by programme. This information would have to remain confidential, but it would enable the Government to monitor the programmes, and BAe's financial health, very closely. In addition, Airbus Industrie last year promised governments that it would produce a 10 year strategic financial plan, giving information about individual programmes. This plan is expected to be available later this year, and should facilitate monitoring of Airbus's progress at the global level.

VIEWS OF FRENCH AND GERMAN GOVERNMENTS

64 The German Government has already taken a decision in principle to give support to the A.330/340. Our German colleagues have told us that a formal Cabinet decision is expected on 28 April.

65 The German Government is expected to finance up to 90% of MBB's development costs (though excluding education costs) on terms which require the company to return only the capital invested in monetary terms. In contrast to their arrangements on the A.320, the German Government will aim to avoid providing additional finance for A.330/340 production. This is likely to lead to some political controversy.

66 The French Government appears also to have decided in principle to support the projects. They are trying to reduce Aerospatiale's direct dependence on the state and will probably

try to negotiate the level of support down to 65-70% of Aerospatiale's development costs. So long as Aerospatiale remains nationalised the concept of the company contributing risk finance is somewhat fictional.

AIR DIVISION
DTI

ANNEX A

ILLUSTRATIVE COMPARISON OF PUBLIC EXPENDITURE POSITION 1987/8 - 1991/2

Each column assumes support provided on £336M.

Column (1) assumes launch aid payable against design and development costs only.

Column (2) assumes £336M of commercial borrowing by BAe is guaranteed, and the related finance charges are advanced by HMG.

Column (3) shows the launch aid payments for the A.320 and in later years, expected receipts under the launch aid contract.

£M

	Launch Aid for A.330/340	Interest Support	A.320 Payments/(Receipts)
1987/8	45	2	44
1988/9	80	9	-
1989/90	78	16	(12)
1990/91	75	24	(50)
1991/92	58	31	(72)
	336	82	(90)

Notes to the Table

i) The launch aid is assumed to be front-loaded and payable against design and development costs. If paid against

all non-recurring costs, the total would be the same but the payments would be accelerated.

ii) The interest support figures assume a 10% rate. Although the cash flow would only reach £109M by the end of 1992, under this route cash outflow would continue and might peak at over £200M by 1997.

iii) Under the interest support route,the rate of return to HMG is less (8%) than under the launch aid route (9.4%) on similar assumptions about the levy profile, because of the need to remunerate the financial intermediaries.

iv) Under the interest support route, the expenditures may increase if the project is delayed or interest rates increase (unless BAe agree to incorporate safeguards against this).

v) If the guarantee associated with the interest support route were called, additional public expenditure would result in later years.

vi) The receipts on the A.320 include £50M on a fixed repayment schedule over 1990-92. The remainder are estimated levies on sales which are considered robust in the light of the present order book. Levies are likely to continue until the end of the 1990's.

ANNEX B

Possible Support Scheme for BAe

i) Total support £336M.

ii) Fixed repayment of £75M in 1994.

iii) The balance to be repaid by means of levies on sales of first 550 aircraft.

iv) Levies to be calculated so that, when aggregated with the fixed £75M. return, HMG would achieve a 9.4% monetary return (cf 7% on the A.320) over 550 sales on a launch aid scheme, or 8% on an interest support scheme.

v) Further levies to be payable if sales exceed 610.

vi) Repayment to HMG to be accelerated if BAe profits exceed pre-determined projections by 10% or more.

All these terms would be subject to negotiation with BAe and there is no certainty they can be achieved.

The scheme would be embodied in a contract between BAe and MoD(PE) and would include a full range of monitoring arrangements to enable regular evaluation of progress.

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cc G. Guise.
B/G/P.

SECRET AND PERSONAL
NOT FOR CIRCULATION

COPIED TO
AGROSPACG: Space Policy
PT2

PRIME MINISTER

AIRBUS AND SPACE

We shortly need to take decisions on whether to provide launch aid for the new Airbus projects and whether to continue our activity in space. The detailed arguments are set out for Airbus in the attached paper, and for Space in the papers which E(A) was due to take place on Thursday. I thought it would be helpful to set these two issues in context.

2 Both these decisions will be politically controversial, and will have repercussions in the House of Commons and, at least in the case of Airbus, at the Election. We have to decide on space by the end of March in order to secure the best possible deal for the UK in time for approval at the Ministerial meeting of the European Space Agency (ESA) in June. The same timetable applies to Airbus since the West German Government has already decided in principle to give support and we understand a formal Cabinet decision will be made late in April. The French Government, also sympathetic towards the A330/340, may well also come to a decision very soon.

3 What are the arguments against our participation? It can be fairly said that the sums of money involved are large, that the pay off in both cases is uncertain and a long way off, and that in a difficult public expenditure situation, these are not the right priorities. But I think these will be difficult arguments to run convincingly during an Election.

DW2BMO

SECRET AND PERSONAL

NOT FOR CIRCULATION

SPACE

4 The UK spent £96m in 1985/86 about the same as India or Canada and much less than Japan's £380m or Germany's £215m. Since then virtually all developed countries have decided to increase their space programme and in 1985 the UK endorsed ESA's decision to increase its budget by 70% in real terms by 1990. We also created the British National Space Centre (BNSC), with considerable publicity, to co-ordinate our space effort and prepare a plan to maximise the benefit from our space activity. It calls for additional expenditure to maintain our share in ESA's increased budget and provide a national programme to exploit the results.

5 Our response will receive considerable publicity. If we do not expand our activity, there will be no point in keeping BNSC. We should have to disband it, in a public reversal of policy which would amount effectively to opting out of most future developments in space. For example without proper participation in ESA there would be no chance of developing the new UK launcher, HOTOL, which we could not afford on our own.

6 I agree with the Chief Scientific Adviser's assessment that we have to choose between being in space properly or not at all. Unfortunately the uncertainties are too great to allow a detailed economic justification for a space programme; the benefits are long term and accrue, at least in part, to future users of space facilities rather than existing suppliers. For the same reason there is only little scope for private sector contribution although UK industry does more than most. But I do not believe this necessarily points towards rejecting involvement in such a challenging and exciting technology. Moreover, the satellite

DW2BMO

communication industry demonstrates that economic benefits can be obtained. I believe there are clear political advantages in our continued involvement in space at a level which allows us to participate actively rather than grudgingly. If colleagues cannot support the request set out in the Space Plan itself, I could accept the reduced level suggested by John Fairclough, although even under his proposals we would still be spending by 1990 only two-thirds of what France spent in 1986.

AIRBUS

7 The A320 enjoyed a successful maiden flight last Sunday with the Prince of Wales, M. Chirac and Herr Strauss present. It has secured over 430 orders and options; and we expect to achieve over the first 600 sales the 7% monetary rate of return agreed with BAe in 1984. You will recall that Kohl first raised the new Airbus project with you at an Anglo-German Summit a year ago. We now have to decide whether the UK should have a continuing role in what is seen as a very successful major collaborative venture in aerospace.

8 I have no doubt that BAe will not participate without considerable Government support even if less than that offered to their collaborators. The French and Germans will offer up to 100% support in grants and guarantees. I am determined we should not go this far, but if we do not take part, the Germans and French will be delighted to take up our share. Is that in our own interests either on industrial grounds or in wider European terms? There would be no chance of returning to the project at a later stage; withdrawal means that some BAe plants might close and British component suppliers would also lose business. A decision now not to

offer BAe some financial support with the prospect of a real return to Government would not be understood by our supporters. Some 70 of our Members with marginal seats have constituency interests in aerospace and we can expect fierce lobbying from BAe.

FUNDING

9 I recognise that these two programmes involve significant public expenditure and that the request comes at a difficult time, although for Airbus, the Government should make a real return over the life time of the project. The sums involved are far too large to be borne by my budget which has, rightly, been reduced by half since we took office. Treasury rules have not allowed me to make any forward provision for launch aid for known but unapproved projects. As for space, I already give this sector high priority within my own resources and it is taking an increasing share of my R&D budget. The Chief Scientific Adviser suggests that Ministers should look to the R&D expenditure of the Ministry of Defence, the Department of Energy and Ministry of Agriculture as potential sources of funding. We have agreed to reduce defence related R&D. If no provision can be made from the Contingency Reserve to deal with these proposals, I would, as Chairman of E(RD), endorse such a move.

RECOMMENDATION

10 I would welcome my colleagues views on:

i authorising the opening of negotiations with BAe for launch aid of up to 50% of the development of the

SECRET AND PERSONAL

NOT FOR CIRCULATION

A330/340 Airbus projects. (I would envisage an "opening bid" of 40 per cent);

ii endorsing a higher level of expenditure on space, at least at the level recommended by John Fairclough;

iii providing the necessary additional expenditure from new money or, failing that, from a mixture of new money and any possible reallocation of funds; and

iv submitting appropriate papers to E(A).

11 I am copying this minute to the Lord President of the Council, the Chancellor of the Exchequer, the Chancellor of the Duchy of Lancaster, the Chief Secretary and to Brian Unwin.

P.C.

PAUL CHANNON

24 February 1987

DW2BMO

Original on AEROSPACE: Space Policy PE2

LR.

action Guise

10 DOWNING STREET

LONDON SW1A 2AA

From the Private Secretary

24 February 1987

Dear Tim,

SPACE AND AIRBUS

E(A) is scheduled at present to discuss this Thursday the British National Space Plan (E(A)(87)6 and 7). The Prime Minister, however, thinks it would be helpful first to hold a small meeting to discuss both space and the provision of launch aid for Airbus, on which DTI have a paper in preparation. E(A) is accordingly to be postponed.

We shall be in touch to arrange a time for a discussion with your Secretary of State and the people to whose Private Secretaries I am copying this letter.

I am copying this letter to Jill Rutter (Chief Secretary's Office, H.M. Treasury), Joan MacNaughton (Lord President's Office), Andrew Lansley (Office of the Chancellor of the Duchy of Lancaster) and to Brian Unwin (Cabinet Office).

Yours,

David.

DAVID NORGROVE

Timothy Walker, Esq.,
Department of Trade and Industry.

6

Original on AEROSPACE: Space Policy Pt 2.

JA2AKQ

CONFIDENTIAL

PRIME MINISTER

SPACE AND AIRBUS

E(A) is scheduled to discuss the UK space programme on Thursday after Cabinet on the basis of the two papers attached.

As asked, the Cabinet Office have set out expenditure by departments, some part of which might be reduced or diverted to help pay for extra expenditure on space. This does not however take things much further forward and it would be difficult for E(A) to reach a conclusion on Thursday on this basis.

As you know, coming along rapidly is the proposal for huge extra expenditure on Airbus launch aid, and discussions on support for Westlands are also in progress.

I have consulted the Lord President through his office to see whether he might be able to make progress on space if he held a meeting with Mr. Channon and the Chief Secretary. He does not think he could, and in any case there would be a lot to be said for taking at least Airbus and space together.

Accordingly, I have discussed with DTI (who are content) and with the Treasury (who have not objected) the idea of a meeting in place of E(A) next Thursday to discuss space and Airbus. This might be attended by Mr. Channon, Treasury Ministers, the Lord President and Mr. Tebbit. It could take note of the position reached by them on Westlands but it would probably not be desirable for Mr. Younger to be present, since his programme is a ~~major~~ potential source of funds for supporting space research. (Mr. Younger and Mr. Channon are to see Sir John Cuckney on Monday.)

Would you be content to postpone E(A) and hold a small meeting in this way?

Yes

DRN

David Norgrove

20 February 1987

CONFIDENTIAL

DIO.

CC/G
dictated to
HC.

DEPARTMENT OF TRADE AND INDUSTRY
1-19 VICTORIA STREET
LONDON SW1H 0ET
Telephone (Direct dialling) 01-215)
GTN 215) 5422
(Switchboard) 01-215 7877

PS/ *Secretary of State for Trade and Industry*

10 February 1987

David Norgrove Esq
Private Secretary to the
Prime Minister
10 Downing Street
London SW1A 2AA

NEA.

Dear David,

AIRBUS

We spoke earlier about recent Press reports, which appeared to suggest that Mr Pattie had said that the Government would agree to provide Launch Aid for the Airbus A330/A340. As requested, I attach a line to take for the Prime Minister's use this afternoon.

Yours ever,

Michael

MICHAEL GILBERTSON
Private Secretary

JG2AUC

999-1

i The proposed A330/A340 programme is clearly very important.

ii However, it is also very expensive, and Government has limited resources.

iii Clearly, the Government is giving the application by British Aerospace for Launch Aid very careful consideration.

iv The Government are aiming to reach a decision as soon as possible in parallel with the other Airbus partner Governments.

v If asked, the Prime Minister should confirm that the Government has not yet taken a decision on the Launch Aid application.

JG2AUE

THE SUNDAY TIMES 8 FEBRUARY 1987

● Europe has rallied to Airbus after American claims of unfair subsidies. IAN WILLIAMS reports on the dogfight

Airbus soars on American anger

TWO SENIOR American trade officials arrived in Europe last week to bang ministerial heads over alleged subsidies to Airbus Industrie, the European plane-making consortium. By the time they left they had scored a remarkable own goal – they had provoked European governments into a ringing endorsement of Airbus – something Europe's aerospace companies had singularly failed to do.

First the two Americans visited Geoffrey Pattie, Britain's industry minister. Airbus "subsidies" were unfair to Boeing and McDonnell Douglas; they were damaging and possibly illegal, the Americans railed.

"They were quite threatening," says Pattie, who does not like being threatened.

By the time the Americans returned to Washington late last week, Pattie had confirmed to The Sunday Times there is now no question but that his department will support Airbus with launch money for its new family of jets – the A330 and A340.

His department's package is likely to go a considerable way towards meeting the £750m request made by British Aerospace, Britain's Airbus partner with 20% of the company. The package will be complete before the end of the month.

Next weekend Pattie will meet ministers from the other Airbus partner countries – France (whose Aerospatiale owns 38%), Germany (Deutsche Airbus owns 38%) and Spain (CASA owns 4%). They will be in Toulouse to finalise their support packages for the new planes, whose development will cost £2.5 billion.

The occasion of their meeting will be Airbus's official roll-out of its new 150-seat plane, the A320, pictured above. With 261 orders and 176 options, the A320 has secured more orders in advance of production than any other aircraft in history.

Jean Pierson, the tough head of Airbus, is expected to use the occasion to announce more launch customers for the A340. Lufthansa (15 plus 15 options) and Air France (seven planes) are the only airlines to have shown their hand so far.

The arrival of the American trade officials last week did not surprise Pattie. Trouble had been brewing for months. The state support Airbus receives is anathema to the Americans. They have totted up $10 billion of it. "And it has not returned a nickel of profit," complained one of them.

As the 17-year-old Airbus consortium has never published any accounts, and keeps financing a closely guarded secret, it is not possible to verify this. But unofficial Airbus sources say support is about half of this level. They also claim that such is the success of the A320, that by the late 1990s it will be able to repay, with interest and profit, its £250m development loan from the British government.

More damaging for Airbus are the accusations that it has been selling its A340 below

Pierson: aggressive selling

Pattie: promising more cash

cost price and has been trying to poach customers that have committed themselves to a rival jet, the McDonnell Douglas MD-11, which was launched late last year.

McDonnell Douglas has claimed that Airbus salesmen offered Alitalia A340s at $10m a time less than anything McDonnell had on offer for MD-11s, and had promised to indemnify the Italians for any penalty they incurred in breaking contracts with McDonnell.

Last week Airbus denied it has been doing anything underhand. One senior source, pointing to the 50-plus launch orders McDonnell has clocked up, said: "A lot of MD-11 orders are not that solid." It is customary, too, for launch customers to get special deals.

Airbus says it is now offering two types of A340. A recent agreement with International Aero Engines for the supply of new fuel-efficient SuperFan engines means customers can opt for a longer-range version, or a shorter range version that carries more passengers.

"Effectively it's now a different plane, so why shouldn't we go back to airlines that have tentative agreements with McDonnell?" asks one source.

Pattie had urged Airbus to cooperate with McDonnell Douglas to take on Boeing, which has 60% of the civil aviation market. Now he says: "The talks may still re-emerge at some stage in the future – over a stretched A340, for instance." But for now he considers the talks closed, and is supporting Pierson in his aggressive search for five launch customers for the A340 by the end of March.

Ultimately, Pattie's irritation with the American officials had a simple basis: he felt they were talking so much poppycock. "It's a tough, competitive business. The sort of activities they complained about are little more than common practice in the airline industry... They just don't like competition."

McDonnell Douglas has its own financing company whose ingenuity in putting together financing packages for the purchase of aircraft has become legend. In one celebrated case in 1983, it whipped an American Airlines order from under the nose of Boeing by fixing up a cheap leasing deal.

And Boeing is no angel when it comes to cross-subsidising planes. Until the arrival of the A340 and MD-11, the Boeing 747 has no competitor in the long-range market. So, effectively Boeing names its price – currently $125m.

Alan Benasuli, aerospace analyst with Drexel Burnham Lambert, the New York investment bank, reckons this means Boeing is making around $20m a plane, or around $700m on last year's sales. As the civil aerospace part of the company is likely to show a 1986 profit of around $300m, it suggests $400m went in supporting the loss-making 767 and 757.

Those figures also show why Boeing is concerned about the likely competition in the long-haul market, and why Pattie thinks it so important to have a European competitor.

Pattie pointed out to the Americans the role of military spending, which, he claims, has supported the development of civil aircraft in America. The 707 was derived from a military aircraft, and the life of the DC10 production line at McDonnell Douglas was extended by military orders for the KC10 tanker, a derivative of the DC10.

Benasuli does not expect America to take punitive trade action against Airbus; it has too much to lose because Europe is an important market for Boeing and McDonnell. Moreover, American engine makers are major Airbus suppliers. Nonetheless, Benasuli does say: "Some kind of trade war is certainly shaping up. It's going to be a blood bath if those two (McDonnell and Airbus) don't collaborate."

THE SUNDAY TIMES 8 FEBRUARY 1987

Billion pound boost to Airbus and Rover

by Ian Williams

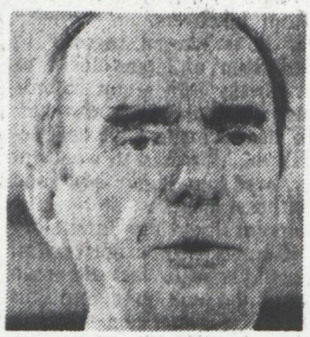
INDUSTRY ministers are preparing plans for a pre-election boost to Britain's aerospace and motor industries which will mean the injection of up to £1 billion of public funds.

Geoffrey Pattie, an industry minister, has decided that British Aerospace must get financial support to remain in Airbus Industrie, the European consortium. He also wants to ensure that Britain participates in the development of a new generation of airliners, the A330 and A340.

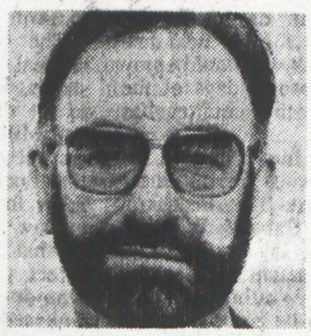
Industry ministers are also in favour of a sanitised version of the Rover corporate plan, presented to them late last year by the Rover boss Graham Day, involving an increase of equity and loans up to £400m.

BAe has asked the government for £750m of repayable launch aid to develop the new Airbus models which will cost £2.5 billion. They are designed to compete with the American giants, Boeing and McDonnell Douglas.

Pattie confirmed to The Sunday Times last week that it is no longer a case of whether his department will support BAe – merely the best way of putting the package together. "We are taking a positive attitude. We are looking at ways in which it can be done," he said. A support package will be ready for discussion elsewhere in Whitehall by the end of the month.



Convinced of backing: Lygo



A stress on continuity: Day

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BAe reckons a decision to support the A330 and A340 will create up to 12,000 jobs in its factories.

Meanwhile, Rover, the state-owned car group, moved last week to quash any suggestion that its corporate plan, now being considered by ministers, will contain any shocks – least of all any serious job losses in sensitive Midlands marginal constituencies.

By contrast, before Christmas it had implied that the plan would be the most radical yet, with everything open to scrutiny.

The plan is likely to stress continuity. The disposal of peripheral businesses such as Unipart and Leyland Bus to their managements will be highlighted, and the sale of Istel to its management will follow. The trucks business will go to DAF of Holland or Paccar of America.

There will be no plan to dispose of Land Rover this year, and any structural change in the Austin Rover volume car business, particularly involving closer collaboration with Honda, is likely to be deferred.

The plan will have to talk money, however, with the Rover Group likely to reveal losses of up to £250m for 1986. Ministers may resist giving a full £400m which could infuriate backbenchers alarmed at the £4 billion of government loans and guarantees the company has already swallowed.

At the least, a modest cash injection, some debt write-off and an increase in borrowing limits are likely when the plan is published in a few weeks.

Airbus soars, page 91

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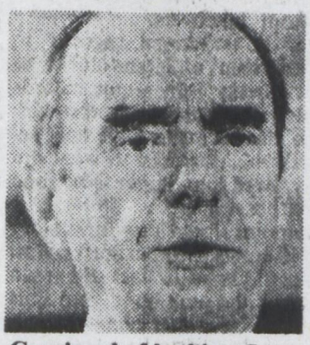
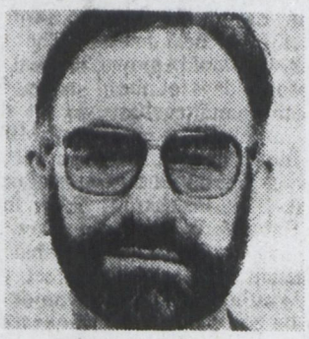


Convinced of backing: Lygo



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Airbus soars, page 91

GRS 60

UNCLASSIFIED
FM LISBON
TO PRIORITY FCO
TELNO 009
OF 141153Z JANUARY 87
INFO PRIORITY PARIS, BONN, MADRID

Your message did the trick.
CDP

MY TELNO 399 : SALE OF AIRBUS TO PORTUGAL.

1. T A P ANNOUNCED YESTERDAY THAT THEY HAVE DECIDED TO PURCHASE THREE A310/300 AIRCRAFT WITH OPTIONS ON A FURTHER TWO IN 1991. THE PRICE FOR THE THREE IS QUOTED IN THE PRESS AS US DOLLARS 250 MILLION, WITH DELIVERY IN SPRING 1988. THE PURCHASE IS REPORTED TO BE ON LEASING TERMS OVER 15 YEARS. A DECISION ON ENGINES IS EXPECTED TO BE TAKEN IN MARCH.

SIMPSON ORLEBAR

YYYY
LPLNAN 3525

LIMITED

MAED
SED
WED
TRED
MR BRAITHWAITE
MR SLATER
MR RATFORD

COPIES TO:

MR BOWDER, AIR DIV/DTI
MR WHITEHEAD, AIR DIV/DTI
NO.10 - 3.

British Aerospace

Prime Minister (9)
[Your message to the Portuguese]
CDP

Sir Raymond Lygo, KCB
Chief Executive

31st December 1986
YL

Dear Prime Minister,

Thank you very much for your help on TAP. I will let your office know of any developments.

With thanks for all your help in 1986 and Best Wishes for 1987.

Yours sincerely

Ray

WBD M211/357/86-1

British Aerospace

CDP
2/2

Sir Raymond Lygo, KCB
Chief Executive

31st December 1986

Dear Charles,

I enclose a short personal thank you note to the P.M. for her help on TAP – and for the matter throughout the year.

Many thanks to you too personally for all your help in 1986. We look forward to an even better 1987

With Best personal

Wishes to you and yours
for 1987

Yours ever
Leg

GRS 150

CONFIDENTIAL

CONFIDENTIAL
FM LISBON
TO IMMEDIATE FCO
TELNO 399
OF 301039Z DECEMBER 86
INFO PRIORITY PARIS, BONN, MADRID

MD

YOUR TELNO 201 : SALE OF AIRBUS TO PORTUGAL.

1. THE PRIME MINISTER'S MESSAGE WAS DELIVERED TO THE PORTUGUESE PRIME MINISTER'S DIPLOMATIC ADVISER ON 24 DECEMBER. MARTINS DA CRUZ SAID THAT HE WOULD PASS IT ON IMMEDIATELY. (HE HAS SUBSEQUENTLY CONFIRMED THAT HE DID SO.) NO DECISION ON WHICH AIRCRAFT TO PURCHASE HAD YET BEEN TAKEN AND THE GOVERNMENT WAS STILL WAITING FOR AN INDICATION OF T A P'S PREFERENCE. THE GOVERNMENT WAS CONSCIOUS OF THE POLITICAL CONSIDERATIONS, BUT TECHNICAL AND OPERATIONAL FACTORS WOULD WEIGH MOST HEAVILY. MARTINS DA CRUZ GAVE NO INDICATION OF WHEN THE FINAL DECISION WOULD BE TAKEN.

2. MARTINS DA CRUZ SAID THAT THE FRENCH AMBASSADOR HAD TELEPHONED EARLIER THAT MORNING. THE AMBASSADOR IS NOW ON LEAVE BUT THE CHARGE HAS RECEIVED NO MESSAGE FROM PARIS. MY GERMAN COLLEAGUE HAS BEEN ASKED TO PASS A MESSAGE TO PROFESSOR CAVACO SILVA FROM A GERMAN JUNIOR MINISTER (BONN TELNO 1117) BUT IS RECOMMENDING THAT THIS SHOULD ISSUE FROM THE CHANCELLOR.

SIMPSON ORLEBAR

YYYY
LPLNAN 3392
LIMITED
MAED
SED
NED
TRED
MR BRAITHWAITE
MR SLATER
MR RATFORD

COPIES TO
MR BOWDER, AIR DIV DT,
MR WHITEHEAD " "

COPIES SENT TO
No. 10 DOWNING STREET

CONFIDENTIAL

SUBJECT
cc OPS
MASTER

10 DOWNING STREET
LONDON SW1A 2AA

From the Private Secretary

24 December 1986

PRIME MINISTER'S
PERSONAL MESSAGE
SERIAL No. T249A/86

TAP and Airbus A310

I have today telephoned the following message to the Duty Officer at the Embassy in Lisbon:

> To the Prime Minister of Portugal: "I understand that TAP is about to announce a decision for new aircraft and that the Airbus A310 is a favoured contender. It would be a particular pleasure to me to see Portugal confirm its support for European collaborative ventures by making this selection. With best wishes for Christmas and the New Year. Margaret Thatcher"

I should be grateful if you could send a confirmatory telegram in due course.

I am copying this letter to Mike Gilbertson (Department of Trade and Industry).

(ANDY BEARPARK)

C.R. Budd, Esq.,
Foreign and Commonwealth Office.

10 DOWNING STREET

LONDON SW1A 2AA

From the Private Secretary

24 December 1986

Thank you for your letter of 23 December enclosing a draft message from the Prime Minister to the Portuguese Prime Minister about the purchase of Airbus A310 by TAP. The Prime Minister has agreed to send the message and we have telegraphed it to our Embassy in Lisbon this morning.

Charles Powell

Sir Raymond Lygo, KCB.

10 DOWNING STREET

Andy.

phoned to Duty Office (Hurd & Cheeseman)
1010
24/12
AJ

I have put Admiral Lygo's letter into the PM.

If she approves the message could you:

(a) telephone it to Embassy Lisbon

(b) tell FCO/DTI you have done so; &

(c) despatch the attached letter to Lygo.

Thanks. C.

010

CF?

1

BRITISH AEROSPACE

BRITISH AEROSPACE
PUBLIC LIMITED COMPANY
11 STRAND
LONDON WC2N 5JT
Telephone: 01-930 1020
Facsimile: 01-839 4774
Telex: 919221

From: Sir Raymond Lygo, K.C.B.

Direct Line: 01-389 3925

Prime Minister
Agreed to send the attached short message to the Portuguese Prime Minister? It is strongly supported by FCO & DTI Ministers.
C.D.P. 23/12.

Mr C D Powell,
Private Secretary to the Prime Minister,
10 Downing Street,
London SW1.

Ref: JW/114

23 December 1986

Yes mt

Dear Charles,

We have received a request from the Administrateur Gerant of Airbus Industrie for the Prime Minister to drop a note to the Portugese Prime Minister on the subject of an imminent decision by TAP the Portugese National Airline to opt for 3 Airbus A310s.

We understand that the decision has been made in principle to opt for the Airbus A310 in preference to the Boeing 767 in order to demonstrate Portugese support for European ventures as a newly joined member of the community. We regard this as an important sale for Airbus at the close of the 1986 year. It would appear that at the last moment the Chairman of the airline, who was about to announce a selection, has been asked to defer a decision by intervention of the Prime Minister. We can only assume that there is pressure coming from the United States to vote for Boeing.

The partners of Airbus Industrie have therefore been asked to produce messages of support from their governments. I understand M. Chirac has been approached to send a message of support as well as Herr Bangamann from the Federal Republic. The choice of senders is I understand dictated by the political leanings of the Portugese Prime Minister who I understand is of the right wing. A suggested draft message is attached.

Yours sincerely,

Ray

Merry Christmas and Happy New Year

cc. Mr J M Bowder
DTI

DRAFT

The Prime Minister
Portugal

I understand that TAP is about to announce a decision for new aircraft and that the Airbus A310 is a favoured contender. It would be a particular pleasure to me to see Portugal confirm its support for European collaborative ventures by making this selection.

With best wishes for Christmas and the New Year.

Margaret

McMul

CONFIDENTIAL

Foreign and Commonwealth Office

London SW1A 2AH

23 December 1986

Submitted separately
CDP
23/12.

Dear Charles,

Airbus Sales to Portugal

I understand that the DTI will shortly be submitting to you a recommendation, along with a draft, that the Prime Minister should send a message before Christmas to the Portuguese Prime Minister, in support of the proposed sale of three Airbus A310 aircraft to the Portuguese airline TAP.

We support this proposal. TAP have been negotiating for some time for a replacement aircraft for their ageing Boeing 707s. The rival candidates are the A310-300 made by Airbus Industrie (AI), in which British Aerospace (BAe) have a 20% share, and the Boeing 767. AI are concerned that this might provide Boeing and/or the US Government the chance to make a last-minute intervention on behalf of the B-767, and BAe wish therefore to suggest that the Prime Minister send a message to the Portuguese Government, if possible before the Christmas break, in favour of the A-310. I understand that Sir R Lygo has now written to the Prime Minister in this connection.

We have consulted the Ambassador in Lisbon, as well as posts in the Airbus partner countries, to find out if similar approaches have been made to those Governments. Lisbon favour a message at Prime Ministerial level to try to clinch the order. Bonn have reported that the German State Secretary at the Economic Ministry (in his Minister's absence) will be sending a message to his Portuguese counterpart, probably after Christmas. Paris report that the Quai d'Orsay are recommending that M Chirac telephone the Portuguese Prime Minister before Christmas.

In our case the Minister for Trade has already lobbied for Airbus during his visit to Portugal in October/November. The only worthwhile addition would be an intervention at Prime Ministerial level.

I understand that if a message can be agreed and dispatched tomorrow the Embassy in Lisbon expect to be able to take action before Christmas.

Yours ever,

Colin Budd

(C R Budd)
Private Secretary

C D Powell Esq
PS/10 Downing Street

CONFIDENTIAL

010

CC PC

DEPARTMENT OF TRADE AND INDUSTRY
1-19 VICTORIA STREET
LONDON SW1H 0ET
Telephone (Direct dialling) 01-215)
GTN 215) 5147
(Switchboard) 01-215 7877

From the Minister of State
for Industry and Information Technology

GEOFFREY PATTIE MP

Charles Powell Esq
Private Secretary to the
Prime Minister
10 Downing Street
LONDON
SW1

CDP
23/12

23rd December 1986

Dear Charles.

AIRBUS A310s FOR PORTUGAL

Mr Pattie has seen a copy of the letter sent to you today by Sir Raymond Lygo of BAe recommending the Prime Minister to send a message to the Portuguese Prime Minister on this subject. WITH CDP

My Minister has asked me to say that he supports Sir Raymond's request, and that he understands that similar requests from Airbus Industrie are likely to be acceded to by M Chirac in the case of France and Herr Bangemann, the Economics Minister, in the case of Germany. I understand that the Foreign Office have consulted the Embassy in Lisbon, and that the Ambassador there has also advised in favour of a message being sent.

Mr Pattie thinks that the draft message attached to Sir Raymond's letter is on the right lines. In view of the urgency, it may be necessary, if the Prime Minister agrees with the recommendation, for you to telephone our Ambassador in Lisbon direct to ask him to convey the message tomorrow, 24 December, if possible.

Yours sincerely,

Tim Abraham

T P ABRAHAM
PRIVATE SECRETARY

DE7/DE7ABF

999-5

10 DOWNING STREET

Prime Minister

The Japanese Embassy ~~tell~~ tell us in confidence that an announcement will be made later today that All-Nippon Airways will buy Airbus.

CD?

hle

SRW

SUBJECT cc MASTER OPS

cc FCO
DTI

10 DOWNING STREET

LONDON SW1A 2AA

THE PRIME MINISTER

19 November 1986

PRIME MINISTER'S
PERSONAL MESSAGE
SERIAL No. T212/86

Dear Prime Minister,

I know that you well understand the very great importance which the United Kingdom and its European partners attach to a substantial increase in quantity of their manufactured goods purchased by Japan. You will recall from previous correspondence between us in 1985, when All Nippon Airways was reaching its decision on the choice of new wide-bodied aircraft, that the procurement of European aircraft such as the Airbus would have been seen as a significant step towards redressing the trade imbalance between Europe and Japan. At that time, following All Nippon Airways' decision to order Boeing 767 aircraft rather than Airbus A300-600s, you wrote to me expressing your personal hope that Airbus Industrie would continue its efforts to win orders from Japanese airlines.

I understand that All Nippon Airways will reach a decision shortly on the type of new aircraft which it will buy to replace its present Boeing 737 and Boeing 727 fleets. As you may be aware, Airbus Industrie is vigorously pursuing with the airline this important opportunity for the sale of advanced technology Airbus A320s which are offered with IAE V2500 engines in which Japanese industry is a substantial participant. The world-wide sales success of the Airbus A320, including large orders from United States airlines, is greatly encouraging and I am confident that, on commercial

ECL

and technical grounds, the Airbus A320 represents a very competitive option. I am sure that in reaching its decision All Nippon Airways will recognise and take full account of the undoubted merits of this aircraft.

With best wishes.

Yours sincerely

Margaret Thatcher

His Excellency Mr. Yasuhiro Nakasone

010

CCPC

DEPARTMENT OF TRADE AND INDUSTRY
1-19 VICTORIA STREET
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(Switchboard) 01-215 7877

Secretary of State for Trade and Industry

PS/

CONFIDENTIAL

17 November 1986

Charles Powell Esq
Private Secretary to the
Prime Minister
10 Downing Street
LONDON
SW1

Dear Charles,

AIRBUS SALES TO JAPAN

My Secretary of State has asked me to write to you seeking the Prime Minister's urgent approval to the proposal that she should write to Prime Minister Nakasone of Japan in support of the latest Airbus Industrie (AI) bid to win a substantial order from All Nippon Airways (ANA), a major Japanese domestic airline. You will recall that the Prime Minister wrote to Mr Nakasone in September 1985 in support of an earlier Airbus campaign to sell A300-600s in ANA. In the event, ANA selected the Boeing 767 aircraft, of which they already operated a sizeable fleet and in the production of which the Japanese aerospace industry participates. In his response to the Prime Minister after the announcement of this ANA decision, Mr Nakasone expressed the hope that AI would continue to pursue future sales opportunities in Japan.

In recent months, ANA has been considering new aircraft of 150-160 seat capacity to replace its ageing Boeing 737/727 fleet. The contenders are the Airbus A320 (for which British Aerospace manufacture the wings) which is offered with the IAE V2500 engine (in which Rolls Royce have a 30 per cent share and the Japanese Aero Engine Corporation a 23 per cent share), the Boeing 737-400 and the McDonnell Douglas MD88. Neither of these US aircraft have any significant UK content. The ANA decision on its choice of aircraft is expected soon - possibly by the end of this month. During their recent visits to Japan, Lord Trefgarne, Mr Spicer and Mr Jenkin have all taken the opportunity to promote the A320 as a suitable aircraft to meet ANA's needs and, of course, as a contribution towards redressing the trade imbalance between Europe and Japan. My Secretary of State will also raise this issue during his forthcoming visit to Japan.

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A senior AI team lead by M. Pierson, AI's President, is leaving for Tokyo on 18 November for final discussions with ANA on the AI bid to supply 10 A320s plus 10 options. AI consider that their A320 bid is highly competitive and that the A320's advanced technology, compared with the derivative aircraft offered by Boeing and McDonnell Douglas, is particularly attractive to the Japanese. The fact that the A320 is offered with engines (V2500) in which the Japanese aerospace industry is participating is also a bonus. AI thus believe that their bid stands a good chance of success, but their major concern is last minute US pressure on the Japanese Government to influence ANA's decision in favour of US manufactured aircraft.

In considering how the Airbus bid might best be supported and any US pressures counterbalanced, AI have reached the conclusion, which my Secretary of State endorses, that parallel letters of support, commending the A320, from the three European Prime Ministers to Prime Minister Nakasone would be helpful. We have established that M. Chirac and Chancellor Kohl are being advised to write to Prime Minister Nakasone in terms broadly similar to the attached draft.

If the Prime Minister is content to proceed on these lines, which my Secretary of State strongly recommends, I should be grateful if Robert Culshaw (Foreign and Commonwealth Office) to whom I am copying this letter would arrange for immediate transmission of the text of the letter, with the original to follow by bag.

Yours sincerely

C Bradley

CATHERINE BRADLEY
Private Secretary

DW1CEP

Please type for PM's signature
CDP
18/xi

DRAFT LETTER FROM THE PRIME MINISTER TO:

His Excellency Yasuhiro Nakasone
Prime Minister
Japan

SRWAMN

I know that you well understand the very great importance which the United Kingdom and its European partners attach to a substantial increase in quantity of their manufactured goods purchased by Japan. You will recall from previous correspondence between us in 1985, when All Nippon Airways was reaching its decision on the choice of new wide-bodied aircraft, that the procurement of European aircraft such as the Airbus would have been seen as a significant step towards redressing the trade imbalance between Europe and Japan. At that time, following All Nippon Airways' decision to order Boeing 767 aircraft rather than Airbus A300-600s, you wrote to me expressing your personal hope that Airbus Industrie would continue its efforts to win orders from Japanese airlines.

I understand that All Nippon Airways will reach a decision shortly on the type of new aircraft which it will buy to replace its present Boeing 737 and Boeing 727 fleets. As you may be aware, Airbus Industrie is vigorously pursuing with the airline this important opportunity for the sale of advanced technology Airbus A320s which are offered with IAE V2500 engines in which Japanese industry is a substantial participant. The world-wide sales success of the Airbus A320, including large orders from United States airlines, is greatly encouraging and I am confident that, on commercial

and technical grounds, the Airbus A320 represents a very competitive option. I am sure that in reaching its decision All Nippon Airways will recognise and take full account of the undoubted merits of this aircraft.

With ~~warm~~ best wishes.

CONFIDENTIAL: COMMERCIAL IN CONFIDENCE:
MARKET SENSITIVE

DA

cc BG

10 DOWNING STREET
LONDON SW1A 2AA

From the Private Secretary

4 November 1986

Dear Catherine,

AIRBUS A330/A340 PROJECT : PROGRESS REPORT

The Prime Minister has seen your letter to me of 31 October reporting the latest position on British Aerospace's application for launch aid for the A330/A340 project. She has noted that your Secretary of State proposes to circulate a paper to E(A) in January 1987.

I am copying this letter to the Private Secretaries to the Foreign Secretary, Chancellor of the Exchequer, Secretary of State for Defence, the Chancellor of the Duchy of Lancaster and Sir Robert Armstrong.

Yours,
David.

(DAVID NORGROVE)

Miss Catherine Bradley,
Department of Trade and Industry.

CONFIDENTIAL: COMMERCIAL IN CONFIDENCE:
MARKET SENSITIVE

SRW

CCBG

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PS/ Secretary of State for Trade and Industry

CONFIDENTIAL
COMMERCIAL IN CONFIDENCE
MARKET SENSITIVE

31 October 1986

David Norgrove Esq
Private Secretary to the
Prime Minister
10 Downing Street
LONDON
SW1

Prime Minister?
MT To be aware.
DRN
3/11

Dear David,

AIRBUS A330/A340 PROJECT : PROGRESS REPORT

As you are aware, my Department received last week British Aerospace's formal application for financial assistance from the Government in launching the A330/A340 project. As expected, they have asked for launch aid of £750 million or about 90 per cent of their total eligible development costs. They have also agreed to examine means of raising finance from the private sector with Government backing in the form of interest support and guarantees. This letter brings you up to date with developments since my Secretary of State's minute to the Prime Minister of 25 July.

Because of a slippage in Airbus Industrie's (AI) timetable, BAe is no longer seeking an early decision from the Government, but Sir Austin Pearce has asked for one in the first quarter of 1987. AI have not yet been able to finalize the technical definitions of the A330/A340 or to make enough progress in marketing the aircraft to airlines to justify a request for early decisions by Government. The position of the French and German Governments on support for their industries participation has not changed since I wrote to you on 6 August. The Prime Minister has, of course, exchanged views with Chancellor Kohl and Prime Minister Chirac on this matter in recent months.

Discussions between AI and McDonnell Douglas about possible collaboration on the A330/A340 ended in September because of the adherence of the parties to the A340 and the competing MD11 respectively. AI considers that further discussions at this stage

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would be counter-productive to their marketing efforts on A330/A340, and Ministers from the UK, France, Germany and Spain, at a meeting during the Farnborough Airshow under Mr Pattie's chairmanship, did not dissent from this.

BAe's request obviously poses significant difficulties. On their present figures expenditure of some £400m might fall in the PES period, and BAe envisage broadly the same level of return to the Government from levies that was agreed for the A320. The application will now be examined in detail by DTI officials, in consultation with the Treasury and the Ministry of Defence, and also with Morgan Grenfell who will advise on possible methods of raising private sector finance for the project. Following this appraisal, my Secretary of State then proposes to circulate a paper to E(A) in January 1987. If Ministers collectively decide that some support should be given, a tough negotiation of the amount and terms would follow, with a view to reaching final agreement with BAe by February or March.

The Chief Secretary has said that he would only countenance Government support for the A330/A340 on the basis of the maximum off-setting savings from agreed DTI programmes. My Secretary of State understands and shares his concern about public expenditure totals. However he has told the Chief Secretary that there is no practical possibility of finding the costs from the existing DTI programme and that Ministers collectively would have to consider the case. It is at Treasury's insistence that there is no provision at all for new launch aid support in DTI's PES base line. If the project is to be supported new money will therefore have to be found.

British Aerospace have agreed that an acrimonious public debate about the prospects for launch aid would serve no useful purpose. However, there is bound to be considerable interest in Parliament and the Press until the issue is settled. We shall take the line that the launch aid application has been received, and that a detailed appraisal of it has been put in hand.

I am copying this letter to the Private Secretaries to the Foreign Secretary, Chancellor of the Exchequer, Secretary of State for Defence, the Chancellor of the Duchy of Lancaster and Sir Robert Armstrong.

Yours sincerely

C Bradley

CATHERINE BRADLEY
Private Secretary

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c. Mr Norgrove (who will wish to note x)

CDP to see

2 pr

CGBG

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MR UNWIN

Mr Wiggins

Noted, thanks. As a when this does come forward, it will presumably have to be treated as a claim on the Reserve.

cc Dr Walker
Mr Roberts

Airbus

7/x/86

I asked Mr Michell (DTI) about the current position on the expected application for launch aid for the Airbus A330 and A340 models.

2. No formal application has yet been received from British Aerospace. Although there have been press reports that the Board of Airbus Industrie would shortly be taking key decisions on the proposed new developments, there is actually no prospect of this happening. DTI now expect to get the application for launch aid in about 10 days' time, and will then have to do a good deal of ground-clearing at official level before any paper goes to E(A), probably some time in November. I have asked to be kept in touch with developments.

x

3. So far as the present financial position of Airbus Industrie is concerned (the topic was raised at the last Anglo-German Summit), the cash shortage is no larger than usual. However, the German and French Governments will need to consider before long whether or not to write-off the loans made at the early development stage of Airbus, before British Aerospace joined the consortium. Mr Michell's view is that these loans will have to be written-off, but the terms of British Aerospace's membership of the consortium explicitly protect the UK from any responsibility for them. However, Mr Michell would clearly not be surprised if

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at a later stage British Aerospace asked to be released from the obligation to repay DTI loans towards the costs of the later had joined the consortium; but this issue is unlikely to arise in the near future.

4. As to Airbus Industrie's current trading results, these are said to be disappointing because competition from Boeing and McDonnell-Douglas - particularly Boeing, who are dumping the 737 - is forcing large discounts in the price of the A320 in order to secure any sales. If the A320 cannot quite be said to be being sold 'at a loss', at the least the contribution earned towards meeting the development costs is disappointing.

JW

A J WIGGINS
7 October, 1986

010

CORG

cc Irish Law

CONFIDENTIAL

P 02214

From: J B UNWIN
29 August 1986

MR WILLIAMSON

cc Mr Wiggins
(for info) Mr Addison No 10

COPY FILE

AIRBUS A330/A340 PROJECTS

Following our conversation this morning I spoke to Mr Channon's office about the Times front page report on British participation in the new Airbus projects.

2. They have instructed the DTI Press Office to take a low key line on the basis that this is a premature report, on which no sensible comment can be made; no decisions have been taken and indeed British Areospace have not yet submitted any formal application for launching aid.

3. I am sure that this is the right kind of response and I have asked DTI to make sure that they relay it to the FCO so that the appropriate guidance can be sent to European posts. Pressure from the industrial lobby can be expected to step up during the Farnborough period, and it is important that all the options for the Government should be kept open.

4. As you know, we have provisionally put this on the agenda for consideration at E(A) on 24 September. DTI believe, however, that this may have to slip. The meeting of the AI Board due to take place in September has now been postponed until October. More information should, however, emerge from the various contacts and discussions at Farnborough, and DTI will keep in close touch with us on progress.

J B UNWIN

CC B/G

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Secretary of State for Trade and Industry

PS/

CONFIDENTIAL
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6 August 1986

David Norgrove Esq
Private Secretary to the
Prime Minister
10 Downing Street
LONDON
SW1

Prime Minister
The response to your request
AW 7/8

Dear David

A330/A340 PROJECTS

Thank you for your letter of 31 July conveying the Prime Minister's questions on the amount of Government support given to British Aerospace's partners in Airbus Industrie (AI).

Aerospatiale and Deutsche Airbus both have shares of approximately 38 per cent in AI compared with BAe's 20 per cent, so one would expect the level of support provided by their Governments to be higher in absolute terms than that received by BAe. However, the support has been considerably higher in percentage terms as well.

Taking the Airbus A320 first, the French Government's commitment is to meet 75 per cent of the development costs incurred by Aerospatiale. In Germany, the Government is committed to meeting 90 per cent of Deutsche Airbus's costs. Government launch aid will cover 54 per cent of BAe's costs. In France and the UK, a modest real rate of return is sought on this investment as well as full reimbursement. In Germany, however the Government seeks reimbursement only. Moreover, production of the A320 will be supported in Germany either by Government guarantee or by some other means yet to be devised. There is no support for production in the UK or France.

As regards the Airbus A330/A340 projects, our information is rather different to that expressed in the Chief Secretary's letter; the German Government has decided in principle to meet up to 90% of Deutsche Airbus' development costs when these have been determined provided the projects appear to be commercially viable. The Government's intention is that support for production of the

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A330/A340 should not be given, and, if this is not agreed, Government ~~support of development~~ costs may be slightly below 90 per cent. Deutsche Airbus, like BAe, will be meeting its own pre-launch costs in 1986. The French Government has recently agreed to meet 50 per cent of Aerospatiale's pre-launch costs of about £22 million compared with the 100% funding sought, and no decision will be taken on the level of funding of Aerospatiale's full development costs until a full case for support is presented. However, French officials believe there will be strong pressure on the Government to meet a very high proportion of Aerospatiale's costs, and that the eventual settlement may again be of the order of 75 per cent.

DTI officials understand that CASA of Spain, which has a 4 per cent share in AI, receives virtually 100 per cent funding for its involvement in the A320 and that the Spanish Government sees no problem in funding CASA's participation in the A330/A340 projects on the same basis. However, it has not been possible to confirm this because of the holiday season.

Officials of France, Germany and the UK will be meeting later this month to compare notes on the cost estimates put forward by their industries in respect of the A330/A340 projects with a view to ensuring that these are kept as low as possible and that one country is not played off against another. DTI officials will also be questioning BAe very closely about the basis for the figure of £840 million which the Company has recently put forward as its share of the development costs.

I am copying this letter to Robert Culshaw (Foreign and Commonwealth Office), Alex Allan (HM Treasury), John Howe (Ministry of Defence), Andrew Lansley (Office of the Chancellor of the Duchy of Lancaster) and to Michael Stark (Cabinet Office.)

Yours sincerely

C Bradley

CATHERINE BRADLEY
Private Secretary

DWLBSK

Aerospace Airbus Pt

004/2762

SECRET
COMMERCIAL IN CONFIDENCE
MARKET SENSITIVE

FROM: CHIEF SECRETARY
DATE: 4 August 1986

PRIME MINISTER

AIRBUS A330/A340 PROJECTS

I have seen a copy of Paul Channon's ~~recent~~ minute to you reporting the possible scale of the British Aerospace (BAe) bid for launch aid. The minute gives no indication of a possible phasing of any payments. But given the sheer scale of the bid, which would amount to some £750 million, the consequences of the Government agreeing assistance of anything like this order would pose very major difficulties on the public expenditure front. There is currently no provision in the DTI baseline for new launch aid contracts. In these circumstances I could only agree to meeting the costs if Paul could make offsetting savings elsewhere on DTI programmes which I recognise would obviously be very difficult.

2 I am also sceptical about the launch aid figures which BAe say their German partners are confident of obtaining. Our information is that the German Government is concerned about the public expenditure involved and that each of the individual Airbus partners is engaged in a game of putting pressure on its own Government by claiming that the other governments have agreed to participate.

3 But, in any case, I do not think we should agree to provide any significant degree of launch aid for these projects. BAe are now a highly profitable private sector organisation with a strong balance sheet. If they wish to continue to participate then they should find the money, not the taxpayer. This is essentially a matter for commercial decision by BAe.

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MARKET SENSITIVE

4 I am copying this minute to Paul Channon, Geoffrey Howe, George Younger, Norman Tebbit and Sir Robert Armstrong.

JOHN MacGREGOR

AEROSPACE AUTOPLUS PT2

8RW

2

cc BG

10 DOWNING STREET
LONDON SW1A 2AA

From the Private Secretary

31 July 1986

Dear Tim,

AIRBUS A330/A340 PROJECTS

The Prime Minister has seen your Secretary of State's minute (undated) about launch aid for airbus projects. She has commented that we must find out how much support BA's partners already receive from their governments and how much those governments are likely to provide for the new projects, in order to prevent the UK Government being black-mailed. The Prime Minister would if necessary be willing to contact Chancellor Kohl and Prime Minister Chirac.

I am sending a copy of this letter to Robert Culshaw (Foreign and Commonwealth Office), Alex Allan (HM Treasury), John Howe (Ministry of Defence), Andrew Lansley (Office of the Chancellor of the Duchy of Lancaster) and Michael Stark (Cabinet Office).

Yours,

David.

(DAVID NORGROVE)

Tim Walker, Esq.,
Department of Trade and Industry.

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SECRET

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MARKET SENSITIVE

We must be in touch with Hold Choice to see how much they are providing. I thought we should be Hardmanised not

Prime Minister? cc BG

To be aware and await comments.

DEV 25/7.

PRIME MINISTER

AIRBUS A330/A340 PROJECTS

While British Aerospace has not yet submitted a formal application for launch aid for the airbus projects, there have been informal contact between the company and my Department, and some Press speculation. You should be aware of developments.

2 Sir Austin Pearce and Sir Raymond Lygo have told me that the BAe Board has concluded that its exposure on civil aircraft is already at the maximum they can justify to their shareholders. BAe's estimate their share of these new airbus projects is about £840m. If they took this on their total exposure on civil aircraft would be some £2.5 billion by 1990, out of all proportion to their turnover in this area, with a consequent adverse effect on their financial performance and share price. The problem is not one of raising the necessary finance, but rather of risk. They feel it is simply too great for a private sector company to bear. Although this might be reduced by a collaboration between Airbus Industrie and McDonnell Douglas, BAe consider that the current talks on such collaboration have only a small chance of success.

?!

How much - how?

3 As you know, BAe's partners in France, West Germany and Spain all receive very substantial support from their Governments. BAe have told me that they are not prepared to

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ie £3/4 billion.

participate in the A330/A340 projects without at least the 90 per cent launch aid which their German and French partners are confident of obtaining. !

4 The Presidents of Airbus Industrie and the partner companies meet at the end of September when Sir Austin will be pressed to state whether BAe would be able to shoulder its share of A330/A340 development costs. The company considers that, in the absence of this degree of support from the Government, it would have to tell its partners at that stage it had decided to withdraw. This would have far reaching consequences for the projects themselves and for the future of Airbus Industrie itself - indeed, BAe's future as a 20 per cent partner in the consortium would be in doubt.

5 It is not clear at this stage whether this is simply the opening shot in negotiations. Sir Austin has asked his staff to give my Department a preliminary case justifying their negotiations for launch aid on this scale. My officials will then examine this as quickly as possible with Treasury and other Departments. In the meantime, I have told Sir Austin Pearce that a request for 90-100 per cent launch aid would create enormous difficulties for the Government. I have made it clear that the taxpayers' interests are no less pressing than those of BAe's shareholders. I am, however, statutorily bound to consider any application for launch aid and have said I will let the company have a preliminary view before the end of September. The difficult foreign and domestic political issues that would arise if BAe were to withdraw from the A330/A340 projects will also have to be addressed.

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MARKET SENSITIVE

6 I shall report again later this summer to you when BAe's proposals have been examined in more detail. I am copying this minute only to Geoffrey Howe, Nigel Lawson, George Younger, Norman Tebbit and also to Sir Robert Armstrong.

PC

PAUL CHANNON

July 1986

DEPARTMENT OF TRADE AND INDUSTRY

JF2BOR

cc JBG

(2)

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From the Minister of State
for Industry and Information Technology
GEOFFREY PATTIE MP

C D Powell Esq
Private Secretary to the
Prime Minister
10 Downing Street
London SW1

Prime Minister
CDP
25/6.

24 June 1986

Dear Charles,

US/AIRBUS TALKS IN GENEVA ON 25/26 JUNE 1986

Mr Pattie has asked me to let you know that a further round of informal talks on trade in civil aircraft will be taking place in Geneva on 25/26 June between senior officials of the United States and those of France, Germany and the United Kingdom. The United States attaches great importance to securing a satisfactory outcome to the talks in order to defuse protectionist pressure in Congress against Airbus, so there could be considerable Press interest in the issue.

The talks were originally conceived as a means of exchanging information and removing misunderstandings about Government assistance to the Airbus Programmes, particularly the A320. However, companies like Boeing and McDonnell Douglas, and their lobbyists in the US Congress, have in recent weeks pressed the US Administration to treat the talks more as an opportunity to renegotiate or reinterpret the GATT Aircraft Agreement of 1980 which in their view does not operate fairly.

The talks are being handled on the European side by the Airbus Intergovernmental Committee, of which the UK is currently in the chair, and on which the FCO is represented. The EC Commission will be represented by an observer. The US officials have been told informally in recent days that a draft text which they have tabled setting out their interpretation of the GATT Aircraft Agreement is not acceptable as the basis for the next week's talks. However, they have also been told that the Airbus countries will do their best to find a solution that will

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put down on paper the progress made in the talks in a form satisfactory to both sides. There is a risk that this will not go far enough to help the US Administration to defuse the issue, in which case action could be taken against Airbus later this summer under US trade and tariffs legislation.

My Minister has discussed this issue recently with his Ministerial colleagues in France and Germany, and has endorsed the line which UK officials and their counterparts plan to take in the talks. He has also agreed that, as US officials will be holding a Press Conference in Geneva at the close of the talks on 26 June and briefing the Press generally during the talks, DTI officials should be free to do the same, either jointly with US officials or separately along with the other Airbus countries' delegations.

I am copying this letter to the Private Secretary to the Foreign and Commonwealth Secretary.

Yours sincerely,

Tim Abraham

T P ABRAHAM
PRIVATE SECRETARY

JE4/JE4ABQ

CONFIDENTIAL

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Secretary of State for Trade and Industry

18 March 1986

Prime Minister
CDP 18/3

C D Powell Esq
Private Secretary to
the Prime Minister
10 Downing St
LONDON
SW1

Dear Charles,

AIRBUS : TALKS WITH US OFFICIALS

My Secretary of State thinks that the Prime Minister will wish to be aware of the talks which are due to take place in Geneva on 20/21 March between senior officials of the US and their counterparts from three of the Airbus partner countries, namely Germany, France and the UK, about civil aircraft trade issues. The talks are likely to attract considerable press coverage in the United States, and there are signs that the UK press will also be reporting on them.

2 The talks were originally suggested to the US Trade Representative, Mr Clayton Yeutter, last December by German, French and British Ministers responsible for trade and industry in response to a strong build-up of protectionist pressure against Airbus in the United States. This pressure nearly led to a recommendation to the US President by the Administration last October that action should be taken against Airbus under US trade and tariffs legislation. This has been averted for the present, but the risk of such action could well return if US officials are not satisfied with the progress of the talks.

3 The US line has been that the Governments of the Airbus partner countries have politically intervened to promote Airbus sales in a way which was inconsistent with the GATT Agreement on Trade in Civil Aircraft. They have also expressed doubt about whether Government launch aid towards development of the A320 aircraft is in accord with the Agreement. The Airbus partner Governments have, of course, told Mr Yeutter and his colleagues that this is not a fair representation of the facts, and have expressed concern that this might, unnecessarily, become an issue

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which might damage their wider economic relations with the US or spoil the excellent cooperation which generally exists between the US and European aerospace industries. The talks at official level are designed to dispel any misunderstanding with the US, and to convince them that their concerns are being seriously considered. Further talks within the next few months will be offered to see whether the viewpoints of the US and the Airbus partner countries can be brought closer together.

Boeing, in particular, has been lobbying hard for US officials to take a tough line in the impending talks, and the Administration is also under pressure from Congress to take action against Airbus, particularly in view of the Congresional elections which take place this autumn. Press interest in the talks, especially in the US, is therefore likely to be considerable. The US side has already been briefing the Press, and DTI officials have been told that this is likely to continue during the period of the talks. As this could lead to a one-sided account of the issues involved, my Secretary of State has authorised DTI officials, who will be accompanied by senior officials from the Foreign Office and our Embassy in Washington, to brief the press, orally or by means of press releases, to the degree which they judge necessary during the period of the talks.

I am copying this letter to Robert Culshaw.

Yours sincerely,

C Bradley

CATHERINE BRADLEY
Private Secretary

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1986
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BICENTENARY

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PART 1 ends:-

PM to Kohl 24.6.85 (T119/85)

PART 2 begins:-

PS/SS DTI to CDP 18.3.86

Grey Scale #13

C Y M

A 1 2 3 4 5 6 M 8 9 10 11 12 13 14 15 B 17 18 19

Colour Chart #13

Blue Cyan Green Yellow

Inches 1 2 3

Centimeters 1 2 3 4 5 6 7 8