

CONFIDENTIAL FILING

Merchant shipping
Shipping Cabotage

TRADE

January 1988

Referred to	Date	Referred to	Date	Referred to	Date	Referred to	Date
	21.1.88						
	27.1.88						
	28.1.88						
	5.2.88						
	16/3/88						
	3.6.91						
	4.6.91						
	27.6.91						
	15.7.91						
	5.9.91						
	13.1.92						
	9.7.92						

PREM 19/3960

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POLICY IN CONFIDENCE



DEPARTMENT OF TRANSPORT
2 MARSHAM STREET LONDON SW1P 3EB

My ref:

Your ref:

The Rt Hon Malcolm Rifkind QC MP
Secretary of State for Defence
Ministry of Defence
Main Building
Whitehall
LONDON
SW1A 2HB

29 JUL 1992

Dear Malcolm,

MERCHANT SHIPPING AND DEFENCE

Thank you for your letter of 8 July.

As I said in my letter of 8 May, this must be a matter for you to decide on defence grounds. The industry will, of course, vehemently dispute the conclusion, pointing to the continuing rapid decline in the British fleet - Ben Line announced last week the disposal of their three large UK flagged container ships. They will also make the point that without more ships it will be difficult to see where extra seafarers might train and find work.

I understand that you feel it would be appropriate to make an announcement today in the context of the Consolidated Fund Debate, when the defence implications of the reduction of the British merchant fleet will be raised. I agree that this would provide a useful opportunity for your announcement.

No doubt your officials will clear with mine, and those of the other interested Departments, the precise wording of the announcement. It will be important that the statement makes the point clearly that there is not a need for special measures on the availability of ships for defence purposes, but there may be a need to do something more on crewing. We must avoid linking the conclusion on ships simply to the question of Defence funding, as implied in your penultimate paragraph.

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/ I am sending a copy of this letter to the Prime Minister, Foreign Secretary, Lord President, Chief Secretary and to Sir Robin Butler.

Yours ever,
J.M.

JOHN MACGREGOR

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MF 48



SECRETARY OF STATE

MO 10/13G

8/17 July 1992

Com - AB/aw(OP)	AUS(14)
B/nw(OP)	AUS(12)
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DAS(P)	D of D Log(Mov)
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DUS(P)	Special Adviser
DUS(P)	

Steve Paul

MERCHANT SHIPPING AND DEFENCE

My Secretary of State has written to yours about Merchant Shipping and Defence. He raised the possibility of some kind of statement before the Parliamentary Recess. We have just learnt that there is to be a short debate following the Consolidated Fund (Appropriation) Bill on 9th July. If your Minister is content with Mr Rifkind's proposals, that would be an opportunity for a low-key statement of the Government position. Perhaps you could let me know by around 1800 on Thursday whether you think we should take up this opportunity.

I am sending a copy of this letter to Stephen Wall (No.10), Simon Gass (FCO), Peter Wanless (Treasury), Tim Sutton (Lord President's Office) and Murdo Maclean (Chief Whip's Office).

Simon Webb

(S WEBB)
Private Secretary

Paul Coby Esq
PS/Department of Transport



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SECRETARY OF STATE

MINISTRY OF DEFENCE
WHITEHALL LONDON SW1A 2HB
Telephone 071-21 82111-23

Copy to:
APS/Min(AF)
PS/Min(DP)
PS/US of S
PS/PUS
DUS(PL)
Sec/CNS
DUS(RP)
DUS(F)
AUS(IL)
AUS(Q)
ACDS(L)
DDNOT
D of D Log(Mov)
IL(Log)
Special Adviser

MO 10/13G

8th July 1992

Dear John

MERCHANT SHIPPING AND DEFENCE

Thank you for your letters about a Government statement on whether or not there is a need to introduce measures to ensure the continued availability of merchant shipping for defence purposes.

I have reviewed the defence arguments put forward by my predecessor regarding the affordability of the proposed scheme. The requirement to take up merchant ships from trade varies widely according to the type of operation or scenario. There is every reason to believe that our requirements could be met in most cases by chartering vessels on the open market when they are required. They would not necessarily have to be British vessels. Many were not in the case of the Gulf crisis. The circumstances in which we would require largely or only British ships are hard to envisage, but there are still enough of the strategic vessels we would require on the British register to meet defence needs.

We do not believe that the acquisition of hulls would be an insurmountable problem even in the worst scenario where we might be acting alone without the support of allies or friends. Given the number of times we have needed to take up shipping from trade over

The Rt Hon John MacGregor OBE MP
Department of Transport



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POLICY IN CONFIDENCE**

the last 30 years, the premium that we might need to pay to acquire vessels even at crisis prices would not appear excessive compared with the year on year cost (perhaps £30M) of a contracting scheme.

However, what concerns us much more is the ability to acquire the necessary British seafarers. I have set in hand some further work on the use of Reserves to ensure our ability to crew the required number of vessels and I will be writing to Ministerial colleagues once we have reached a conclusion. This is an area where a much more modest investment would provide a better return for any money that Government might make available. Legislation is likely to be needed and I hope that colleagues would support me in achieving a suitable priority in the legislative programme.

In coming to the above conclusion we have taken into account the points raised in your subsequent letter sent last week. I do not believe that the Grove report says anything new about the state of the merchant fleet and that has not been already been well publicised. We are all aware that the merchant fleet numbers are declining and that this trend looks set to continue and that this is not the most desirable development for defence interests. The report concludes that we could rerun an operation such as Corporate but only with difficulty due to a smaller pool of vessels from which to choose, and that a particular shortfall is in the number of RORO ferries available. The paper does not consider the availability of Dependent Territory vessels when it discusses "the reliable militarily useful fleet". Defence calculations take these figures into account: of particular significance are 10 Bermuda based BP tankers. The 166 ships that the paper quotes as militarily useful and which are described as "the only ships that can be fully relied upon in worst case scenarios" are similar to the original 159 ships for the original merchant shipping for defence contract scheme. There are other options available to us to meet our requirements which the paper largely ignores in trying to demonstrate that the industry requires strong Governmental support. The paper is a thinly disguised attempt to justify the

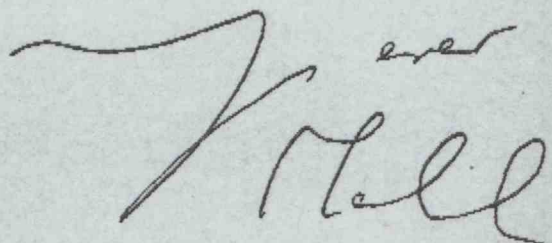
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POLICY IN CONFIDENCE

fiscal concessions that the Chamber of Shipping have been pressing on the Treasury for some time. Your department would be better placed to reply substantively.

The measures being proposed by the US Transport Secretary appear similar to those proposed in the contracting scheme. This does not materially affect our assessment that, in the UK situation, the proposals do not represent good value for public money (even allowing for the fact that the US scheme appears to be funded and administered by the US Department of Transport!)

In conclusion, I have to say that I could not justify funding the cost of a contracting scheme alongside all the other competing requirements for defence funds. As for an announcement, I am prepared to tell Parliament that as a result of the review of defence requirements for merchant shipping in times of crisis we have concluded that we do not propose to support the industry from defence funds but that I am investigating measures to ensure that there would be an adequate supply of British seafarers. I am copying this letter to the Prime Minister in view of his earlier interest; if he agrees I propose to make this announcement before the Recess.

I am sending a copy of this letter also to the Chief Secretary, and to Sir Robin Butler.



Malcolm Rifkind

C/ ●
could you check
with William,
please?

f No - no
Q
G
DE

Sue Ambler - Edwards
veng. The farm d-wards
the is going to be taken
from a letter sent by
Rifkind to MacGregor - which
we should have a copy of



10 DOWNING STREET

De Et William?

Does have a doll?

Will

9/7

William,

*Amend
Thanks -
but there is
no WAK!! W 9/7*

*There is no form of words
as such but it will be
along the lines of attached
letter from Secretary of State
for Defence.*

*Amend
9.7.92*



SECRETARY OF STATE

MO 10/13G

8/17 July 1992

Dear Paul,

MERCHANT SHIPPING AND DEFENCE

My Secretary of State has written to yours about Merchant Shipping and Defence. He raised the possibility of some kind of statement before the Parliamentary Recess. We have just learnt that there is to be a short debate following the Consolidated Fund (Appropriation) Bill on 9th July. If your Minister is content with Mr Rifkind's proposals, that would be an opportunity for a low-key statement of the Government position. Perhaps you could let me know by around 1800 on Thursday whether you think we should take up this opportunity.

I am sending a copy of this letter to **Stephen Wall (No.10)**, Simon Gass (FCO), Peter Wanless (Treasury), Tim Sutton (Lord President's Office) and Murdo Maclean (Chief Whip's Office).

Yours sincerely
Simon Webb

(S WEBB)
Private Secretary

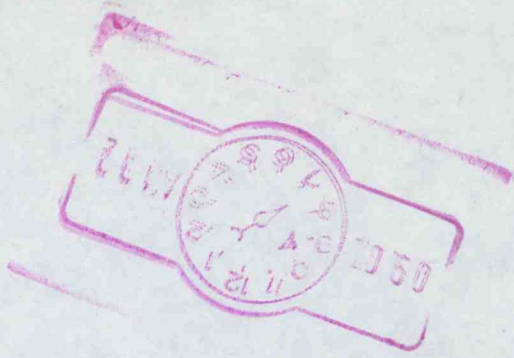
Paul Coby Esq
PS/Department of Transport



Recycled Paper

GRADE: Cabotage

Jan 88



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VB



10 DOWNING STREET
LONDON SW1A 2AA

From the Private Secretary

6 March 1992

Dear Justin,

MERCHANT SHIPPING AND DEFENCE

The Prime Minister has seen the Chief Secretary's minute of 4 February, Mr. Rifkind's minute of 26 February and your letter of 28 February to me. As the Prime Minister understands the situation, if we make an announcement of policy on the lines of the Chief Secretary's minute we shall satisfy neither the merchant shipping industry nor those MPs who are concerned. We are not in a position to announce the fall back since neither the Secretary of State for Defence nor the Secretary of State for Transport will accept the £18 million figure as a charge on their budget and the Chief Secretary does not accept it as a charge on the reserve. Nor would that sum meet the concerns of the shipping industry.

In the circumstances, the Prime Minister concludes that we should make no announcement for the time being. If the matter is raised in the debate on the Budget we shall have to say that the subject is still under review.

I am copying this letter to Jane Binstead (Ministry of Defence), Bronwyn Hill (Department of Transport) and Sonia Phippard (Cabinet Office).

Jane,
[Signature]
J S WALL

Justin Wray, Esq.,
H.M. Treasury.

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ca

PRIME MINISTER

MERCHANT SHIPPING AND DEFENCE

Following my minute of 28 February I have talked to Treasury, MOD and Transport. It is clear

- i. that to announce a decision to make no payment to secure the future availability of merchant ships would provoke protests from the merchant shipping industry and from some MPs;
- ii. we are not in a position to announce the possible fall-back of annual payments to ship owners in return for their ships being kept or brought on to the UK shipping register because neither Mr. Rifkind nor Mr. King is prepared to foot the bill and the Chief Secretary does not accept it as a charge on the reserve. Moreover, although such a scheme would meet the anxiety of some MPs about our defence needs, it would not satisfy the shipping lobby.

The Treasury, MOD and Department of Transport are all happy with the alternative of making no statement. If the matter is raised in the debate on the Budget, the Treasury are happy to say that the subject is still under review. If you agree, I will minute out accordingly.

Stephe

J.S. WALL

5 March 1992

foreign\merchant.dca

1/68

Bromley Hill

*See Thanks. Pl. proceed
as you suggest / 29.2*

PRIME MINISTER

MERCHANT SHIPPING AND DEFENCE

Flag A Andrew Turnbull noted in his letter of 15 July last year that no agreement had been reached between the Ministry of Defence, the Department of Transport and the Treasury on whether the decline in the British merchant fleet had reached a point where measures were needed to stem the out-flow. Andrew asked on your behalf for this to be pursued, recording your view that there was no economic case for fiscal help to the shipping industry and that any help should be related to defence objectives.

Flag B Following inter-departmental discussion since then the Chief Secretary has minuted saying

- (i) Mr. King has concluded that there is no defence case for a subsidy;
- (ii) there are nonetheless scenarios in which there would be a vital need for defence access to merchant shipping; but
- (iii) it would be neither justifiable nor affordable to make a substantial and permanent subsidy to the industry;
- (iv) there should therefore be no continuing payment in order to secure the future availability of vessels;
- (v) the possibility should be examined of taking legislation to ease and speed the requisitioning of British-owned, but foreign-flagged, ships;
- (vi) Mr. King will also explore a scheme to enhance the availability of merchant seamen within the Merchant Navy and Royal Naval Reserves.

The above proposals were all agreed by Mr. Rifkind and Mr. King.

Justin Rose

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- 2 -

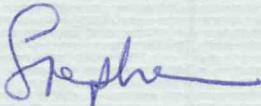
Mr. Mellor's minute includes a fall-back in case you consider that one is needed on political grounds. This would involve annual payments to a number of ship-owners who would, in return, undertake to keep or bring ships on to the UK shipping register to ensure the availability of a pool of British-flagged and crewed ships for defence purposes. Under the scheme attached to Mr. Mellor's minute this would cost up to £18 million a year.

Flag C Mr. Rifkind has written supporting the fall-back.

Flag D Mr. Mellor's office have written expressing surprise at this, given that the first option (i.e. no special scheme) had been agreed beforehand. Mr. Rifkind suggests that funding should fall on the Reserve. Mr. Mellor repeats his view that funding must be a matter for negotiations in the survey.

Unless you have strong views at this stage, I will pursue further the issues:

- (i) whether the pressure for some action in support of the British Merchant Fleet is as great as Mr. Rifkind implies
- (ii) whether we can keep the "review" going until after the Election. Since there will be no Finance Bill until after the election postponement is probably a realistic option.



(J. S. WALL)

28 February 1992

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Treasury Chambers, Parliament Street SW1P 3AG

071-270 3000

Fax 071-270 5456

Stephen Wall Esq CMG LVO
Private Secretary
10 Downing Street
London
SW1

28 February 1992

Dear Stephen,

MERCHANT SHIPPING AND DEFENCE

The Chief Secretary has seen Mr Rifkind's minute of 26 February to the Prime Minister. The Chief Secretary was surprised by it: his minute of 24 February had been agreed beforehand with Mr Rifkind and Mr King.

2. In his second paragraph, Mr Rifkind commends offering now the fallback option that was set out in paragraphs 10-14 of the Chief Secretary's minute of 24 February. Moreover, Mr Rifkind goes on to imply that funding should fall neither on his nor Mr King's department, but on the Reserve.

3. The Chief Secretary's minute makes clear that Mr King "does not believe that a continuing payment in order to secure the future availability of vessels would represent good value for money when judged against other claims on the defence budget." Against this background, the joint recommendation was that "the Government announces that there is no sufficient defence case at present for further assistance to British shipping." The agreed minute also made clear that the funding of a scheme would be a matter for the Survey.

4. I am copying this letter to Simon Webb, Simon Whiteley and Sonia Phippard.

Yours sincerely
Justin Wray

JUSTIN WRAY
Assistant Private Secretary

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PRIME MINISTER

MERCHANT SHIPPING AND DEFENCE

1. I have seen David Mellor's minute of 24 February responding to your request of last July that we consider whether the decline of the British fleet had reached the point where intervention was necessary on defence grounds.

2. I believe that there might be a political case for now offering a limited defence contract scheme, in advance of forthcoming debate on this year's Finance Bill. Last year, it was clear that many supporters of the industry's case were primarily concerned about the implications, for our defence interests, of a declining merchant fleet. Understandably, this is an emotive issue on which many of our own supporters continue to express serious concern. It would be much easier for colleagues, who are again being lobbied by shipping interests in the run up to this year's Budget, if we were now able to offer the defence contracts scheme as evidence that the Government had seriously considered the defence issue and had identified a method of safeguarding our defence requirements. This would, I am sure, take most of the political steam out of the shipping industry's campaign for subsidies. It would, however, require an addition to the defence budget and I fully recognise the difficulty which Tom would have in giving the scheme priority within his existing provision.

3. I also agree that the announcement of our review of the defence implications of the fleet's decline should be for Tom to make. We should seek to avoid the idea that this announcement will be an indication of the Government's stance on general economic subsidies for the shipping industry. On that front, the Chancellor made it very clear at the time of last year's Budget that he saw no case for singling out the industry for special

treatment. As far as I am aware this remains the position and it is one which I shall, of course, myself defend if faced with renewed lobbying for concessions this year.

4. What Parliament is now expecting is a statement specifically on whether the Government thinks that the continuing decline of the fleet currently presents a threat to our national defence interests and, if so, the steps which will be taken to counter that threat. Archie Hamilton has recently answered a Parliamentary Question about the review and I am sure that Parliament would continue to expect that it is only the Ministry of Defence which can, with authority, speak on the question of the nation's defence needs.

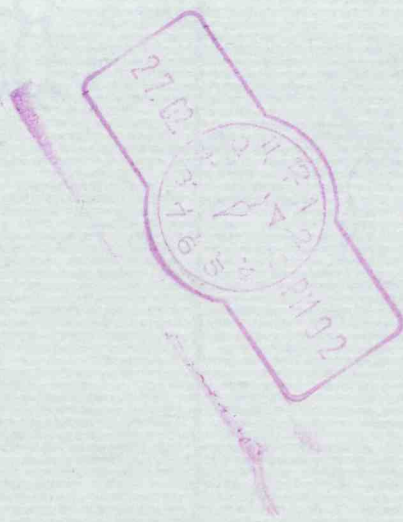
5. I am copying this minute to Tom King, David Mellor and Sir Robin Butler.

MR.

MALCOLM RIFKIND
26 February 1992



GEORGE WASHINGTON



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B cc ps



FROM: CHIEF SECRETARY
DATE: 24 February 1992

PRIME MINISTER

MERCHANT SHIPPING AND DEFENCE

Andrew Turnbull's letter of 15 July records your agreement that:

- (i) there is no economic case for fiscal help to the shipping industry. If any help is to be given, it should relate to defence objectives;
- (ii) such help should take the form of direct subsidies rather than changes in the tax regime.

2. You asked the Treasury, Ministry of Defence and Department of Transport to consider whether the decline in the British fleet had reached the point where intervention was necessary; I have discussed the way forward with Tom King and Malcolm Rifkind.

Background

3. The military need for merchant shipping in times of war and crisis may be met in a variety of ways. Ships of any nationality may be chartered if available. British owned/British flagged ships may be requisitioned under the Royal Prerogative for defence of the Realm. British owned but foreign flagged ships may be requisitioned (once emergency legislation is in place).

4. The UK registered trading fleet has declined substantially, from more than 1600 to 508 vessels between 1981 and the end of 1991, with a fall of dead weight tonnage from 43.3 million to 3.9 million. It is very difficult, however, in respect of the

defence requirement, to identify when it becomes essential to arrest the decline. Experience of the Falklands and the Gulf shows how difficult it is to define a minimum defence requirement.

The Way Forward

5. Tom King has considered the defence case for a subsidy but, although he reconfirms that there are scenarios in which there would be a vital need for defence access to merchant shipping, he has concluded that it would be neither justifiable nor affordable within current provision to make a substantial and permanent subsidy to the industry for such an insurance arrangement.

7. The UK has required merchant ships only twice in the last 30 years, for the Falklands and the Gulf, and in each case it has been possible to acquire sufficient vessels. There are, of course, dangers in reading across too readily: the Falklands was 10 years ago when the UK register was healthier and the Gulf, which enjoyed universal and UN support, proved, for merchant shipping, to be an operation in relatively protected waters.

8. Against this background, Tom does not believe that a continuing payment in order to secure the future availability of vessels would represent good value for money when judged against other claims on the defence budget.

9. We have been unable to resolve the question of who would announce a decision not to pursue a special scheme. In my view, it would be most appropriate for Tom to make a brief announcement, as this would tie the issue firmly to the defence need for shipping. Any subsequent lobbying by the industry on the economic case for assistance would be for Malcolm to handle in the usual way, or for Treasury Ministers if specific tax proposals were involved.

Fallback

10. I am, of course, acutely aware of the potential political consequences of announcing a decision that we do not intend further to assist the industry. Last year both Francis Maude and

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I were forced to say that the Government was looking at the defence case for assisting British shipping and that a statement would be made in due course. The shipping industry has now brought forward similar Budget proposals to last year's which we cannot be certain that the House could be persuaded to resist.

11. Against this background, officials have worked up the details of a scheme which could be introduced as a fallback, if you decide that action is needed now on political grounds. It is a smaller and adapted variant of the scheme which emerged last year as the most likely to be cost effective. Payments would be made annually to a number of shipowners who would, in return, undertake to keep or bring ships on to the UK register, so ensuring the availability of a pool of British flagged and crewed ships for defence purposes. I attach a paper describing it in more detail.

12. The cost of the scheme would depend on the chosen scenario. The example in the Annex would be targeted at 90 ships, at a cost of up to £18 million a year, and would offer a level of military utility in a range of NATO and out of area scenarios. It would offer a capability to lift a force of similar size to that which we took to the Gulf, subject to certain changes in methods of operation. It would carry some deadweight to cover for inevitable non-availability. Officials are examining the scope for further reducing the costs.

13. A scheme of this size and nature would not satisfy the shipping industry. But it would be primarily aimed at those outside the industry who, without some gesture of this kind from the Government, will continue to press for (much more costly) tax concessions.

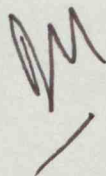
14. The funding of a scheme would need to be discussed in the Survey. Tom King has made it clear that a scheme's priority would not justify a place in his programme at existing levels of provision.

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Conclusion

15. To conclude, we recommend that the Government announces that there is no sufficient defence case at present for further assistance to British shipping. The possibility will be examined of taking legislation to ease and speed the requisitioning of British owned but foreign flagged ships. Tom King will also explore a scheme to enhance the availability of merchant seamen within the Merchant Navy and Royal Naval Reserves. However, such measures have attendant difficulties and will not be seen by the industry as removing the case for tax concessions. If a fallback is needed to meet the political pressure for action on defence grounds, I suggest that the contract scheme outlined above would offer the least expensive way forward.

17. I am copying this minute to Tom King, Malcolm Rifkind and Sir Robin Butler.



DAVID MELLOR

MERCHANT SHIPPING AND DEFENCE CONTRACT SCHEME (MSDCS)**Background**

This note [by MOD and DTp] outlines a modest scheme designed to counter the continuing decline in the UK flagged or owned merchant fleet. It assumes that a scheme is required which involves public expenditure (rather than tax relief) and is capable of being ringfenced on the grounds that it meets a defence need only. In these circumstances, the preferred solution is to offer contracts to the owners of certain strategic vessels, ensuring UK registration and a specified level of British crew in return for an annual payment. Subject to its acceptability to the shipping industry and the vagaries inherent in the normal trading patterns of the contracted ships (which would be unaffected), the MSDCS would aim to ensure that there was a pool of strategic ships potentially available to the UK, manned with necessary levels of loyal personnel, subject to UK law and suitable for UK security vetting, in order to meet a level of basic defence requirement in circumstances where other vessels were not available.

Scheme content

2. The number of ships covered by an MSDCS can be varied according to need and available resources. Appendix 1 to this paper describes an MSDCS covering 90 ships and assesses the military utility attaching to it.

3. General features of an MSDCS are as follows:

- a. the scheme is targeted particularly at categories of ship which are in scarce number on the British register. Contracts would not be made for ship types for which availability was comfortably in excess of requirement;

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- b. for those categories of ship whose trading patterns are particularly geographically widespread, the number of contracts made would exceed the defence requirement in order to assist availability;
- c. tenders would be sought on a competitive basis, with the usual application of operational suitability and value for money criteria. Owners of suitable foreign-flagged vessels would be invited to tender (and re-flag) alongside owners of vessels currently on the UK flag;
- d. contracts would be for a specified period;
- e. the MSDCS would provide only for situations of crisis.

EC law

4. Provided that an MSDCS can be shown to meet a clear defence need, no contravention of EC law is foreseen.

Cost

5. In the absence of market testing, firm estimates of cost cannot be provided. However there should be a clear relationship between the extra costs of keeping a ship on the British register compared to flagging out and the cost of the contracts. Informal estimates from the industry put such costs at up to £200,000 per ship per year. On this basis an annual cost of up to £18 million for 90 ships can be derived.

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MERCHANT SHIPPING DEFENCE CONTRACT SCHEME

Composition of 90 ship scheme

Break Bulk General Cargo

Above 10,000 DWT	10
Refrigerated Cargo	7
Cruise Ships	7
RO/RO's	50
Heavy Lift	1
Container	1

Product Tankers

5,000 - 14,999 DWT	8
15,000 - 60,000 DWT	6
TOTAL	= 90

The ships listed above do not include those for which there is a defence requirement, but which are currently in good supply on the UK register.

Capability

2. The vessels covered by this option are the minimum number in scarce categories that would need to be guaranteed to enable the UK to mount an amphibious deployment of 3 Commando Brigade, together with the deployment of 3 UK Division, 24 Air Mobile Brigade, plus supporting Rapid Reaction Force (Air) elements, in a range of NATO and out of area scenarios.

3. This option takes into account the reduction in overall UK military capability following the drawing down of forces. However it is calculated in the absence of firm guidance on scenarios for the commitment of our forces under the new NATO concepts, and details of the composition of our forces and their supporting stocks of munitions in the post Options era. It would enable the movement (assuming the use of air transport in parallel) of 30-35,000 troops, including support, and their equipment. In broad terms this would give an Operation Granby

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level of capability, with certain changes in operating practice e.g. the use of mostly larger ships. For comparison, some 50 merchant ships of a range of sizes were used in the Falklands.

4. This number of vessels is less than ideal. It imposes severe constraints on planning flexibility, notably by requiring larger vessels to be targeted than the Army prefer, imposing mixed commodity loading eg ammunition and vehicles, and reducing flexibility in berth selection.

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TRADE: Merchant
Shipping Jan 88



ccpc

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MINISTRY OF DEFENCE
WHITEHALL LONDON SW1A 2HB
Telephone 071-21 82111/3

SECRETARY OF STATE

MO 10/13J

13th January 1992

David

file

MERCHANT SHIPPING AND DEFENCE

file with JSW

Thank you for your letter of 20th December

I am content with the holding line you propose. But as you know, our search for practical and cost effective alternatives to fiscal change has not been successful and it does not look as though it will be. Your early dismissal of the case for fiscal change is consistent with the position we took last summer, but that was partly based on the expectation that a public expenditure alternative could be found.

I am copying this letter to the Prime Minister, Malcolm Rifkind, Peter Lilley and to Sir Robin Butler.

Tom King

Tom King

The Rt Hon David Mellor QC MP
Chief Secretary to the Treasury



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TRADE: Merchant Shipping, Jan 58



[Faint handwritten mark]

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~~cc PU~~



DEPARTMENT OF TRANSPORT
2 MARSHAM STREET LONDON SW1P 3EB

My ref: R/PS0/20062/91

Your ref:

10 JAN 1992

The Rt Hon David Mellor QC MP
Chief Secretary to the Treasury
HM Treasury
Treasury Chambers
Parliament Street
LONDON
SW1P 3AG

Dear David,

*He
with Tom?*

Thank you for copying me your letter of 20 December to Tom King about merchant shipping and defence.

I agree with the form of the response you propose to send in answer to the letter of 4 December from the Chamber of Shipping. It is consistent with the line we have taken publicly in answer to other questions on the subject and it is clear that we are not yet in a position to make any more substantial statement. It would, incidentally, be helpful if your letter could reach Mr Everard before I address the Chamber's annual dinner, on 15 January.

I do however think that we should meet with Tom King as soon as possible to settle the defence issue properly. Delay can serve only to increase the possibility of further losses from the British flag.

You will also, of course, be aware that the Chamber of Shipping has now submitted its proposals for the 1992 Budget. It would be greatly preferable, before considering how these should be treated, to have reached and announced a final conclusion on the defence case for assistance and thus to ensure that defence and economic arguments are kept distinct.

I am copying this letter to the Prime Minister, Tom King, Peter Lilley and to Sir Robin Butler.

MALCOLM RIFKIND

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Handwritten signature and arrow pointing to the seal.

Handwritten initials 'ccp'.

Treasury Chambers, Parliament Street SW1P 3AG

071-270 3000

Fax 071-270 5456

Handwritten note: 'By / coal' with a yellow highlight and a signature.

The Rt Hon Tom King MP
Secretary of State for Defence
Ministry of Defence
Main Building
Whitehall
London
SW1A 2HB

20 December 1991

Handwritten signature 'Dh'.

MERCHANT SHIPPING AND DEFENCE

Handwritten note: 'FILE WITH JSW'.

Thank you for copying me your letters of 9 and 16 December to Malcolm Rifkind. I have also seen Malcolm's response of 11 December. I am sorry it has not been possible to find a mutually convenient time to meet in the near future.

2. I think we can leave a substantive discussion of the points you and Malcolm have raised until after Chevening. But, in the meantime, I do need to respond to the Chamber of Shipping's call for the promised Government statement on merchant shipping and defence. I attach a copy of a letter I have recently received from Michael Everard, who has taken over as President from Lord Sterling.

3. I propose to say that "the Government is continuing to review the defence requirement for merchant shipping, and how this might best be met. This takes time. There are complex issues involved, and we have not yet reached a conclusion. I can say that we are not persuaded that changes to the tax system would be cost-effective, but we are continuing to consider whether there are any other options that would be practical and cost-effective."

4. I would be grateful if you and Malcolm could let me know as soon as possible whether you are content with this holding line.

5. I am copying this letter to the Prime Minister, Malcolm Rifkind, Peter Lilley and to Sir Robin Butler.

Handwritten signature of David Mellor.

DAVID MELLOR

RESIDENT:

MICHAEL EVERARD

Telephone: 071-283 2922

THE CHAMBER OF SHIPPING

30-32 ST. MARY AXE

LONDON, EC3A 8ET

4 December, 1991

Mr Bob Dunn MP
House of Commons
LONDON SW1A 0AA

Dear Bob,

I am writing, as the new President of the Chamber of Shipping, to keep you in the picture about the position facing British Shipping and to seek your continuing support in carrying on the campaign, begun last year by my predecessor Lord Sterling, for the adoption of measures to stimulate new investment in ships and the employment of British seafarers.

You will recall that, during the closing debates on this year's Finance Bill in July, two senior Treasury Ministers - Mr David Mellor and Mr Francis Maude - promised that a Government statement would be made following a review of defence requirements in relation to merchant shipping. That followed the swell of pressure generated in the House by you and your colleagues, for Government action to stem the declining numbers of UK-registered ships and British seafarers.

No statement has yet been issued.

The position facing British shipping companies continues to worsen. The need for urgent action is demonstrated by several new facts:

- the UK owned and registered fleet has again contracted (by 7%) over the last year and the number of UK-owned ships now operated under totally foreign flags (rather than the UK mainland or British dependencies) is twice the level of two years ago - see attached chart;
- more well-known British shipping companies are moving their ships/crewing arrangements offshore or have left shipping altogether;
- the average age of our ships and seafarers is continuing to increase alarmingly;
- new assistance measures continue to be announced in other European countries. These include firm plans by Sweden to set up an international register which will include a full exemption of seafarers from income tax and social security liability and by the Netherlands to present new proposals for support measures for the Dutch shipping industry early next year. These are in addition to the extensive aid already applicable in these and other countries.

There is no doubt that the action you and we called for last year is more necessary now than ever. While appreciating the sensitivity of this pre-election period, the starting point must be to remind Ministers of the importance of the assessment they are undertaking in regard to the defence aspect and of consulting the industry fully prior to producing any proposals. The latter is particularly important if any measures which may be proposed are to be of a practical and useful nature. It would be unfortunate if - as happened last year with the 183-day foreign earnings provision - measures were put forward in good faith, but which were likely to prove counterproductive in their implementation in many cases.

You may be interested to know that the Chamber will shortly be making a further submission in connection with next year's Budget, which will re-state our call for a 100% ship allowance and an alleviation of seafarers' income tax. It will also contain a number of technical improvements and safeguards relating to these proposals, which have arisen from suggestions made during this year's campaign.

I very much hope we shall continue to have your strong support.

Finally, in case you were unaware of the change, I should record that the General Council of British Shipping reverted to its earlier title of "The Chamber of Shipping" as from October.

Please do not hesitate to contact either me or Mark Brownrigg, the Chamber's Director of Shipping Policy and External Relations, if you require any further information.

Your sincerely,

Michael



Texas: Merchant Shipping
Jan 88

upc



MINISTRY OF DEFENCE
WHITEHALL LONDON SW1A 2HB
Telephone 071-21 82111/3

SECRETARY OF STATE

MO 10/13G

16 December 1991

Malcolm

MERCHANT SHIPPING AND DEFENCE

ALB WITH JSW

Thank you for your letter of 11th December. I am sorry that you disagree so strongly with my position, set out in my letter of 9th December.

Clearly we need a meeting to resolve this, and I will respond to the points you make then. However, to summarise my position - I agree entirely that there is a strategic need for merchant shipping. I would greatly prefer to see British (in all respects) ships available to meet that need. There is however a tide away from the British flag which I do not believe (nor I think does the shipping industry) that affordable Defence expenditure can stem. In the circumstances I am obliged to examine alternatives.

I am copying this to the Prime Minister, Norman Lamont, David Mellor and to Sir Robin Butler.

Tom King

Tom King

The Rt Hon Malcolm Rifkind QC MP
Secretary of State for Transport



TKADG : Merchant Shipping, Jan 88





DEPARTMENT OF TRANSPORT
2 MARSHAM STREET LONDON SW1P 3EB

My ref:

Your ref:

The Rt Hon Tom King MP
Secretary of State for Defence
Ministry of Defence
Whitehall
LONDON
SW1A 2HB

11 DEC 1991

Dear Tom

MERCHANT SHIPPING AND DEFENCE

Thank you for your letter of 9 December in which you indicate that you are not prepared to carry forward our proposals for a scheme to ensure the availability of merchant shipping for defence purposes, on which our officials have been working since the summer.

I was extremely disappointed with this response, and find unsatisfactory the arguments invoked to support it.

You have never disputed the strategic need for merchant vessels. More than that, as you know, our officials produced a paper in June which underlined our concern that, whilst it was just possible at that time to meet our defence needs, further decline in the merchant fleet could make it impossible for us to run a Falklands-type operation or to fulfil our NATO role in Europe. We wrote to the Prime Minister highlighting this concern in July.

My Department has long agreed that it is very difficult to make a case for treating the shipping industry more favourably than any other on economic grounds and the present review of the need for Government assistance has therefore focussed strictly on the defence requirement for merchant shipping.

It is nonetheless important to remember that calls for assistance for the industry generally have not abated since the unsuccessful bid for concessions in this year's Finance Act and that the evidence of discontent amongst British shipowners has continued to grow. In the absence of positive action, we must expect such shipowners, increasingly persuaded of Government's indifference to its future, to take decisions on the flagging and crewing of its vessels which reflect a hard-headed assessment of its own commercial advantage and which could further jeopardise our national defence interest.

Officials have gone a long way towards developing a scheme which could harness competitive commercial pressures to safeguard, at minimum cost, a core fleet of strategic vessels with loyal British crews. This appears to be being discarded not because it lacks merit but because you are not prepared to pay for it.

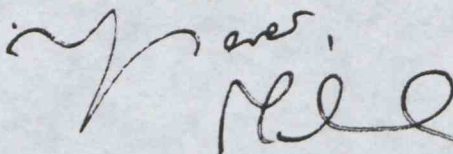
While I recognise that the financial considerations are significant, I am very worried that your new alternative proposal fails to address the very problems which we set out in our earlier paper, for the same reasons which were rehearsed then.

While vessels may normally be obtained through chartering on the open market, as in the Gulf conflict, this will not always be the case. Are you confident that the market would be able to provide the vessels needed in a future conflict similar to that over the Falklands, where the UK's position might have less wide international support?

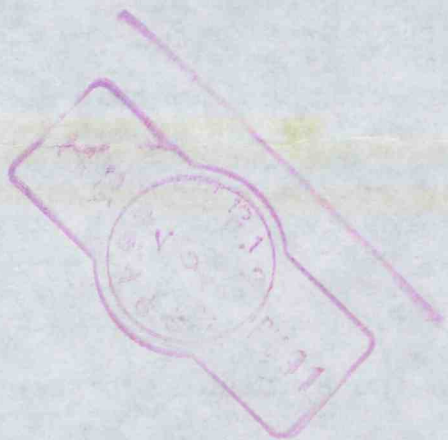
Reliance on existing powers of requisition means that we must secure emergency legislation before obtaining any vessels other than those flying the British flag and our officials have already discussed some of the difficulties which would attend strengthening our powers of requisition; including the ability to hide parent ownership through complex hierarchies of subsidiaries and the difficulty of securing the passage of the enabling legislation, which would be considered very unattractive in many quarters. A particularly serious problem would, of course, be the inability to guarantee that vessels would be loyally crewed at the time of requisition. I am afraid that reliance on a reserve pool of British seafarers is unlikely to be a realistic option when you recall that recent studies have shown that supply of British seafarers is not keeping pace with wastage rates from the industry and that, without the fiscal incentives which the industry sought to help balance the high costs of employing British seafarers, the trend towards cheaper, foreign crews - witnessed recently by Cunard's decision to replace British ratings with Filipinos - is likely, regrettably, to continue. Without the incentive to employ British seafarers it follows, of course, that there is no incentive to recruit and train them. It is therefore difficult to see how you envisage a viable reserve of British seafarers being sustained.

In the meantime, Parliament is still waiting for the announcement which the Chief Secretary promised in July. In the circumstances, I agree that we need to meet, urgently, to discuss the matter with colleagues.

I am copying this letter to the Prime Minister, Norman Lamont, David Mellor and to Sir Robin Butler.



MALCOLM RIFKIND



CONFIDENTIAL

*CEC
PJ-*



SECRETARY OF STATE

→ Andrew
File
Wattian

MINISTRY OF DEFENCE
WHITEHALL LONDON SW1A 2HB
Telephone 071-21 82111/3

*File with all
our pps attached*

MO 10/13D

9 December 1991

*Where have the
earlier papers
referred to in
Simon Webb's letter?*

Malcolm

*2/36
10/12*

MERCHANT SHIPPING AND DEFENCE

My Private Secretary's letter of 8th October said that I believed the scheme, devised by officials, to contract for the retention of some 150 vessels on the UK register in order to safeguard defence access to them was both too large and too expensive. I asked officials to consider whether a more modest scheme could be prepared.

The original scheme would have borne both on ships' retention on the UK register and on their crewing. It would also have provided financial support to the British shipping industry. My PES 91 settlement funds the force structure for Britain's defence in the 90s, and the cost of transition, but there is no margin for new commitments of this kind, and I have already undertaken to absorb some significant cost growth on key projects. You will understand, therefore, that a contracting scheme, however tailored, involves commitment of considerable resources and does not offer a worthwhile return. A smaller scheme than first envisaged would be cheaper, but value for money would if anything worsen.

The Rt Hon Malcolm Rifkind QC MP
Department of Transport

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SECRETARY OF STATE

My first preference would, of course, be to have available a British flagged and crewed fleet large enough to provide us with all the vessels we require in crisis and war. Unfortunately the market continues to move us away from this position, and I do not think that defence expenditure can stem this tide. There are however other ways of obtaining hulls:

- a) through chartering on the open market, as we did during the Gulf crisis, and if necessary through outright purchase of vessels;
- b) through the requisition of British owned foreign flagged vessels.

The need is then to ensure the availability of loyal and appropriately qualified crews. There is the Merchant Navy Reserve, and the existing pool of RN reservists might be made available in times of crisis. A fully worked up scheme, expanding upon these existing reserves, needs more work and may not be easy, but would be consistent with well established principles of military readiness in other areas. We should also examine development of our existing emergency powers which might affect crews as well as the requisitioning of the vessels themselves. I suggest that both our Departments should undertake this work.

I recognise that the shipping industry expects Government money after its Finance Bill campaign. But I do not think that the industry is looking for direct defence expenditure as a solution to its perceived problems and I cannot contribute limited defence funds to a scheme which does not offer value for money within overall defence priorities.

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SECRETARY OF STATE

The Prime Minister has asked us to consider whether the moment has come to intervene by means of expenditure with the industry. It follows that, in terms of defence expenditure, it has not. We may need to meet colleagues to discuss this, not least because David Mellor's statement during the Finance Bill commits the Government to a response, which cannot be long delayed - we have both had Questions in the House in recent weeks.

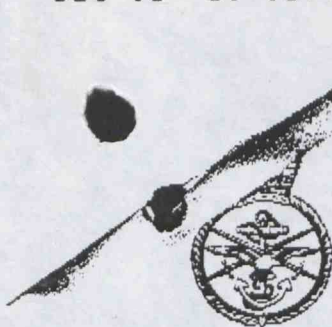
I am copying this to the Prime Minister, Norman Lamont, David Mellor and to Sir Robin Butler.

TK

lan

Tom King

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S3A

MINISTRY OF DEFENCE
WHITEHALL LONDON SW1A 2HB
Telephone 071-21 82111/3

SECRETARY OF STATE

MO 10/13J

SH October 1991

Dear Sir,

MERCHANT SHIPPING AND DEFENCE

On his return from the Far East, the Defence Secretary saw your Secretary of State's letter together with the paper by officials which it mentioned. His reaction was that the scheme put forward was both too large and too expensive to have any serious prospect of success, given that additional funding would have to be provided. He has asked officials here to work with yours to produce a much more modest proposal based on the idea that it would be desirable to have a basic core of British flagged shipping available for defence purposes to which we would add in time of crisis by either "ransom price" charters or outright purchases. Mr Hamilton is also exploring whether there could be a role for naval reservists in providing British crews, but the Defence Secretary very much doubted whether it would be necessary to pay the full differential in crew costs, given the other attractions of keeping under the British flag.

When officials have worked up a much more modest proposal, the Defence Secretary would be ready to have a word with your Minister about whether this is worth presenting to other colleagues.

Yours sincerely
Simon Webb

(S WEBB)
Private Secretary

Simon Whiteley Esq
PS/Secretary of State for Transport



Handwritten notes:
A checkmark and 'A.I.O.N.'
'C.P.C.' and 'P.A.' with a checkmark

Treasury Chambers, Parliament Street, SW1P 3AG
071-270 3000

5 September 1991

Rt Hon Tom King MP
Secretary of State for Defence
Ministry of Defence
Main Building
Whitehall
LONDON
SW1A 2HB

Dear Tom

MERCHANT SHIPPING AND DEFENCE

As you will know, the relevant new clause on this subject was not selected at the Report Stage of the Finance Bill and it was not necessary for us to give any specific undertaking on future help for Merchant Shipping. It is clear that matters will not rest there, however, and we must now seek to reach an agreed position on whether the moment to intervene has come and, if so, what the precise nature of the scheme should be.

In his letter of 15 July, Malcolm Rifkind suggested that officials should finalise details of the number and types of ship required for defence purposes, and should draw up the outlines of a contract scheme. I understand that a start has been made on this, but more work is needed if we are to be able to meet the Prime Minister's remit.

First, the contract scheme must be explored in sufficient detail to establish that it really does offer a viable means of addressing the problem in a cost-effective way. Though this option was identified in the earlier paper by officials, it was not explored in any depth. A proposal along these lines was considered - and rejected - in 1987. We need to be sure that the balance of argument has changed. We must also establish, for example, that a scheme of this sort would be consistent with our Community obligations.

flap

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It will also be essential for the proposal to be worked up in sufficient detail to provide reliable estimates for the costs year by year: without these, there is no way of judging priorities. Given the current pressures on public expenditure, I remain convinced that any additional costs must be found within existing provision. As my officials explained to yours, however, this is clearly an issue for the Survey, and can only be pursued in that context.

Copies to the **Prime Minister**, Malcolm Rifkind, David Mellor and Sir Robin Butler.

A handwritten signature in black ink, appearing to read "Norman Lamont".

NORMAN LAMONT

TRADE: Merchant Shipping Jan 88

File



10 DOWNING STREET

LONDON SW1A 2AA

From the Principal Private Secretary

15 July 1991

Dec Jeremy.

MERCHANT SHIPPING AND DEFENCE

The Prime Minister has seen the report by officials which was attached to the Chancellor's minute of 25 June and the joint minute by the Secretaries of State for Defence and Transport of 10 July. The Prime Minister agrees that:

i. there is no economic case for fiscal help to the shipping industry. If any help is to be given, it should relate to defence objectives;

ii. such help should take the form of direct subsidies rather than through changes in the tax regime.

It follows, therefore, that the Government should continue to resist the attempts to amend the Finance Bill by the shipping lobby.

The Prime Minister has noted that there is still no final agreement between the three departments on whether the decline in the British fleet has reached the point where measures are needed to stem the outflow. He is content with the form of words suggested in the Chancellor's letter of 12 July as a holding line. The Prime Minister hopes it will be possible for the three departments to resolve the outstanding point of whether the moment to intervene has come and, if so, what the precise nature of the scheme should be. He is concerned about the current pace of flagging out.

I am copying this letter to Simon Webb (Ministry of Defence), Simon Whiteley (Department of Transport), Tim Sutton (Lord President's Office), Gillian Kirton (Lord Privy Seal's Office), Murdo Maclean (Chief Whip's Office) and to Sir Robin Butler.

Your needs
Andrew Turnbull

ANDREW TURNBULL

Jeremy Heywood Esq
HM Treasury



DEPARTMENT OF TRANSPORT
2 MARSHAM STREET LONDON SW1P 3EB

My ref: R/PSO/11237/91

Your ref:

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

15 JUL 1991

Des Norman,

MERCHANT SHIPPING AND DEFENCE

- with 45? / will require by req'd.

You wrote to Tom King on 12 July proposing a form of words to be used if there is a debate on shipping during the Report Stage of the Finance Bill. I can accept what you propose. But I doubt it will hold the line for anything more than the immediate future.

As Tom and I said in our joint minute of 10 July, the failure of the GCBS' campaign is likely to lead to a further exodus from the UK flag unless we take steps to staunch the flow. The form of words you have proposed may be enough for Parliamentary purposes but it is not going to convince shipowners, who are driven by hard, commercial realities. Unless we can announce within the next few weeks that we are taking action, which probably means contracting for certain ships to stay on the UK register with British crews, we shall quickly start to lose more tonnage.

The paper by officials showed that the supply of British flagged and crewed ships has reached a critical level. If more ships are flagged out, I cannot see we shall have any alternative but to try to retrieve the position and probably at a greater cost than if we had simply contracted in the first place to keep sufficient ships on the UK register.

I suggest we now ask officials to finalise urgently both details and numbers of ship types needed for current defence planning requirements for which we may need to contract with shipowners and the basic details of a contractual scheme. This should be sufficient to decide what to do and to inform any announcement of our intentions. The fine detail of a contractual scheme could be settled later, in consultation with the merchant shipping industry.

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I am copying this letter to the Prime Minister, Tom King and Sir Robin Butler.

over,
Malcolm Rifkind

MALCOLM RIFKIND

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chex.kf/sj2/85

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Treasury Chambers, Parliament Street, SW1P 3AG
071-270 3000

12 July 1991

Rt Hon Tom King MP
Secretary of State for Defence
Ministry of Defence
Main Building
Whitehall
LONDON
SW1A 2HB

Context

Tom King

*Prime Minister.
As you requested, HMT, MID & DTp
studied the shipping/defence arguments. They
agree
(i) no economic case for help, but MOD & DTp
thought there was a defence case, HMT
agrees
(ii) any help should not be via taxation
but through an explicit operational
subsidy.
Ch/G suggests a holding line. If
we get through the Finance Bill, the
issue can be sorted out - PES.
Context with line suggested*

MERCHANT SHIPPING AND DEFENCE

I am grateful for the copy of the joint minute which you and Malcolm Rifkind sent the Prime Minister, and for your agreement that tax concessions are not the way forward.

Over the coming weeks we will need to look in detail at the requirements for shipping in time of conflict and the options for meeting these. We are clearly not in a position to announce the outcome of this study during the Report Stage of the Finance Bill next week; equally well, we must mount a robust defence against the attempts to re-introduce capital allowances.

We have discussed the issue with a number of senior backbenchers. I believe that to carry the day we will have to show that we are prepared to give serious consideration to alternative approaches, but that it will not be necessary to give a precise commitment. I would propose David Mellor takes the following line if there is a debate on Monday:

"The Government fully recognises the contribution which our merchant shipping fleet can make in times of conflict. It is a matter which we - and our partners in NATO - keep regularly under review. Indeed, we are at present engaged in an up-to-date study of our requirements for shipping in times of conflict and the options for meeting them. It is a complex subject and it is by no means a simple task either to define

*The "staying"
clause was
defeated in Committee
(it seems unlikely
to speak into allow
them to be reintroduced
but a line is needed
just in case.*

AT (2)

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these requirements or to decide how best, where necessary, they could be met within what is affordable. The tax route is not the way. But I can assure Hon Members that we will not hesitate to take action, including expenditure, if we judge it to be effective and justified by our defence requirements."

I would be grateful for your, and Malcolm's, agreement to this form of words. It would be helpful if your offices could telephone mine on Monday morning.

I am copying this letter to the Prime Minister, Malcolm Rifkind, John MacGregor, David Waddington, Richard Ryder and Sir Robin Butler.

A handwritten signature in dark ink, appearing to be 'N. Lamont', written in a cursive style.

NORMAN LAMONT

MERCHANT SHIPPING AND DEFENCE

We have now received a joint minute from Tom King and Malcolm Rifkind on merchant shipping and defence. This follows an earlier note from Norman Lamont.

The situation has now become clearer-cut. Transport and Defence accept the Treasury's view that there is no economic case for assisting the shipping industry. They believe that there is, however, a defence case for doing something.

What do they recommend?

They have narrowed the various options in an earlier paper by officials down to one. They recommend contracting with shipowners to make specific UK flagged and British crewed ships available for defence purposes. In other words, they propose paying the shipowner the difference between the cost of having a British crew and a "third-world" crew.

How much would this cost and would it work?

The official paper estimated that the cost could be in the order of £200,000 per ship per year for most vessel types. It speculated that there might be a need for 100-150 ships. That would suggest a cost of £20-30 million per annum.

It is clear, however, that these estimates are very much a shot in the dark. The truth is that MOD and DTp do not yet know how

any ships they would need. Nor do they know what type of vessel they want. In other words, they are asking you to sign up to a commitment that is effectively open-ended. Until we have some more robust estimates of what our defence requirements are, I do not see how you could do so.

Furthermore, the details of how a contract might work are still very sketchy. Would there be a system of tendering to make sure that we had to pay as little as possible? Would the payment simply be calculated on the basis of the difference in cost between a British crew and the cheapest alternative? Would the owner of a contracted ship have to undertake to make his ship available within a certain period, incurring a penalty should he fail to do so? What might the impact be on the wages of British seafarers in the type of vessel likely to be contracted?

These kinds of issues would clearly have to be resolved before we could go firm on an announcement.

Who will pay?

DTP says that MOD should pay. MOD says that HMT should stump up new money. HMT says that any money would have to be found from within existing provision and form part of the PES negotiations. I do not believe that we should yet concede that there will be new money:

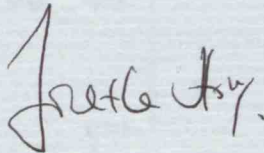
- (a) because we don't know how much might be needed;
- (b) because we should keep the pressure up on MOD and DTP to work up a realistic and carefully targeted scheme.

Handling the politics

There has been a lot of support from our Backbenchers for the GCBS lobby. Members have been trying to put pressure on the

speaker to allow a debate at Report Stage (on Monday 15 July) of the GCBS's two main proposals for fiscal measures. He has resisted that. There will be no discussion.

So the issue for us is whether - having disappointed our backbenchers on Monday - we want to offer them some comfort at Third Reading on Tuesday. It should be possible to come up with a form of words which while not committing us to anything, would suggest that MOD and Transport would sit down with the industry to see whether we could devise a scheme which could relate directly to the defence issue. I am told that the GCBS - although unhappy in private - would not be critical in public. And it should be enough to keep our supporters quiet.

A handwritten signature in dark ink, appearing to read 'Jonathan Hill', written in a cursive style.

JONATHAN HILL

258.JH

~~CONFIDENTIAL~~ ~~CCP~~
P.U.
110 JUL 1991

PRIME MINISTER

MERCHANT SHIPPING AND DEFENCE

- with AT?
1. Norman Lamont has sent you a paper prepared by officials analysing the case for helping the shipping industry and the options we might consider.
 2. It seems to us that the paper reached a very important conclusion: namely that, whilst it is just possible at present to meet our defence needs, further decline in the merchant fleet could make it impossible for us to run a Falklands type operation or to fulfil our NATO role in Europe, leaving aside the needs of civil resupply, although the likelihood of the requirement has receded for the present. Nor can there be any real doubt that the decline will continue. Since the officials' paper was finalised, the UK flag fleet has fallen again from the figure quoted of 4.1m deadweight tonnes to 3.9m dwt.
 3. If we do nothing to stop the trend of recent years, then we run an increasing risk that, at least in some circumstances, insufficient merchant shipping will be available for military purposes. As Norman says, we do not have a clear view of precisely what the risks are at present; we never shall because the future is not predictable. The defence of the Falklands in 1982, for example, was not a scenario for which we had planned. But we were fortunate enough to have sufficient merchant ships for the task force. What we do have is a precise idea of merchant shipping requirements for current defence planning scenarios. It is quite clear that in terms of these requirements the supply of reliable British flagged, British crewed ships has reached a critical level.
 4. We believe the case is therefore made for some assistance to the UK shipping industry and there is no need for further work. Defence is at the heart of this case, although as we said

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in our earlier minute, the merchant fleet is - and is seen to be - a national asset in a wider sense as well. We accept Norman's view that there is no economic case for support. Nevertheless, any assistance would have wider benefits in terms of the commercial well being of part of the industry and, for that reason too, would be welcome to many of our supporters who have endorsed the GCBS's campaign for assistance.

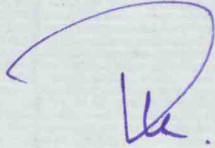
5. We agree with Norman that fiscal measures are not the way forward. We need to find a mechanism which is tightly focused on the types of ship which are most critical and which also encourages the use of British crews. This would minimise costs and help to ring fence the support. Out of the options in the officials' paper, the idea of contracting with shipowners to make particular UK flagged and British crewed ships available for defence purposes seems the most attractive. The available evidence suggests that the cost penalty of operating UK flag ships with British crews may be up to £200,000 per ship, depending on the size and type of ship, compared with realistic alternative methods of operation. Further discussions would be needed but it should be possible to devise a workable scheme that could enable us to contract for a limited number of critical ship types at a figure somewhat below the actual cost penalty.

DTP estimate £20-30 million a year

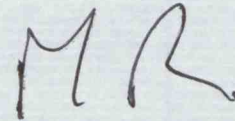
6. The almost certain failure of the GCBS' campaign is likely to lead to a further exodus from the UK flag unless we take steps to staunch the flow. So there is a strong case for making an announcement soon that we are prepared to contract for certain ships to stay on the UK register with British crews.

7. Norman says that any funds for additional help for shipping should be found from existing provision. Unfortunately this is not possible as there is no money to meet it. Since this contracting scheme is intended as a much less expensive alternative to the range of fiscal measures that the GCBS have been calling for, and deals with the kernel of the argument around which the GCBS build their much more substantial claim, we hope that Norman would feel able to support this.

/ 8. We are copying this minute to Norman Lamont and Sir Robin Butler.



TOM KING
Secretary of State for Defence



MALCOLM RIFKIND
Secretary of State for Transport

CONFIDENTIAL

Amey. PLS

Can you please show this to
the PM before he comes to
the Whip's Dinner at 7-30pm
tonight.

TO: THE CHIEF WHIP

8 July 1991

FROM: NICHOLAS BAKER MP

Revised.

FINANCE BILL - SHIPPING

1. Following an EDM signed by 354 MPs from all parties two new clauses were put down for the Finance Bill, the first (now NC 5) providing for first year 100% capital allowances for ships, the second (now NC 6) providing for relief from taxation upon sums paid to mariners. Both have been signed by about 175 MPs of whom 103 are Conservatives.
2. These new clauses are being promoted by Lord Sterling of P & O who have applied enormous pressure on colleagues to obtain measures favourable to shipping. Jonathan Sayeed was against the campaign until his appointment as PPS and Giles Shaw, William Clark and Michael Mates have taken up the running.
3. During the Committee Stage David Shaw was going to move NC 5 but at the last moment withdrew under intense Sterling and constituency pressure. James Arbuthnot proposed NC 5 and a short debate followed which provided an opportunity for Francis Maude to give a clear and full explanation of the government's reasons for opposing it; substantial cost (£750m over 5 years), help for ships built abroad as well as in Britain, the small chance of such an expensive and untargetted measure making any reverse to the decline of the UK merchant fleet, possible difficulties with EC rules and the precedent for claims by other hard-pressed industries were cited. The new clause was negatived by the Committee.
4. Under the rules of the House the new clause having been debated and voted upon by the Committee would not ordinarily be considered on Report but the large number of signatories could encourage the Speaker to allow this (and he admitted as much to me). The Speaker, with whom you have spoken and I have now seen twice, is aware of the heavy commercial lobbying and is now further incensed that Giles Shaw, a member of the Chairman's panel and aspirant Speaker, should have organised written lobbying of the Speaker to call the new clause on Report. NC 6 incidentally is clearly out of order and will not apparently be called in any event.

/continued over.....

5. At my last meeting with the Speaker he assured me that he would definitely not call NC5, would not hesitate to explain openly why if pressed, and asked me to notify Giles Shaw of this, which I have since done. The Speaker had also received a complaint from William Clark that NC 5 with his name at its head had been re-tabled without his permission. The Speaker also gave me to understand that he would be disinclined to call any further new clause on this subject that might be tabled. I agreed that this was proper, the matter had been debated and suggested that proponents of the new clause might be permitted to raise shipping in the Third Reading debate as they wished to air the matter and professed not to want a vote. The Speaker doubted that this would be in order. It seems certain that the Speaker will not call NC 5 but I remain concerned that he will bow to pressure to allow a debate on any new clause tabled about shipping. My view remains the same, although the Opposition on Friday tabled an amendment to NC 5 restricting capital allowances to ships made in the U.K. which would undoubtedly fall foul of EC rules. It is however, possible that the Opposition will press for a debate on NC 5.
6. Meanwhile the Office has started work to persuade colleagues to take their names off NC 5. So far 21 names have been removed and more should follow. Heavy pressure is still coming from Sterling & Co. and, although many colleagues say that they would not vote against us on this, and a few seem unaware that their names are on the new clause, we are mounting a fierce effort this week to reduce the names on NC 5 to an absolute minimum. Reducing this number is vital to facing NC 5 if we have to debate it, now unlikely, or the new clause on shipping which we must expect.
7. I will watch out for any sign of another new clause and will continue to stick close to the Speaker who will be subject no doubt to more pressure this week. The Report Stage is scheduled for Monday 15 and Tuesday 16 July and new clauses can go down for debate at any time until Friday 12.



THE DEPARTMENT
OF TRANSPORT

MSM AT 1/7



per
James

FROM THE SECRETARY OF STATE

2 MARSHAM STREET LONDON SW1P 3EB
TELEPHONE 071-276 3000

Andrew Turnbull Esq
Principal Private Secretary
10 Downing Street
LONDON SW1A 2AA

My Ref:

Your Ref:

28 JUN 1991

Dear Andrew,

MERCHANT SHIPPING AND DEFENCE

The Chancellor minuted the Prime Minister on 25 June enclosing a paper by officials which meets the request in your letter of 30 May for advice on current trends and whether a Government response is needed to correct them. My Secretary of State and Mr King are considering the Chancellor's minute.

You also asked in your letter for advice on whether the Prime Minister should give Lord Sterling an opportunity to make a presentation on this issue. There would be no real value in such a presentation. The GCBS's position is well understood in Whitehall. Lord Sterling will want to press for assistance on a scale and in a manner which my Secretary of State would not wish to support and nor, I understand, would other Ministers.

Nevertheless Lord Sterling is a key figure in the GCBS's campaign and a major influence in the British shipping industry and, arguably, should be given an opportunity to put his case to the Prime Minister at first hand. The Prime Minister may also feel that for wider political reasons he should agree to see Lord Sterling and, on balance, my Secretary of State would recommend that he do so - but he would certainly not press the point.

I am copying this letter to Simon Webb (Ministry of Defence), Jeremy Heywood (Treasury) and to Sir Robin Butler.

Yours ever,
Peter McCarthy

PETER MCCARTHY
Private Secretary

with AT?

~~As to see~~

I do not propose to bother
the Bureau with this but
it seems a respectable
enough position.

Jim



Treasury Chambers, Parliament Street, SW1P 3AG
071-270 3000

27 June 1991

ccp

Dominic Morris Esq
Private Secretary to the
Prime Minister
10 Downing Street
LONDON
SW1A 2AA

mabpm

Dear Dominic,

SHIPPING

Thank you for your letter of 4 June *hop* to Jeremy Heywood reporting the Prime Minister's meeting with Jonathan Sayeed MP. The Prime Minister will now have seen the Chancellor's minute of 25 June and the paper prepared by officials.

You asked in your letter whether the Chancellor had considered the argument that Clause 43 of the Finance Bill might further encourage the decline of the British merchant fleet. The Chancellor has considered this argument, but is not convinced by it.

Clause 43 extends the tax exemption on overseas earnings for people who work abroad for long periods. It allows seafarers to keep the exemption even if they are in the UK up to half of each year (previously they were only allowed to be in the UK for 3 months in each year). There is now obviously more incentive for seafarers who previously did not qualify for the exemption to work away from the UK long enough to qualify. It is possible therefore - though not a foregone conclusion - that, having worked on inshore and short-sea ships in the past, some will now choose to work on deep-sea vessels, most of which are foreign-flagged.

Against that, the rules for existing deep-sea seafarers are in effect being relaxed. They will find that they will not need to work for so long on deep-sea voyages to qualify for the relief. It is entirely possible that a number of them will choose to spend the minimum time on deep-sea voyages to qualify for the relief,



and the remaining time on short-sea voyages nearer home. This will tend to increase the number of seafarers wanting to work on UK-flagged short-sea ships.

It is unlikely, however, that either of these effects would be very marked.

There is one other consideration. Looking at the picture for seafarers overall, the Chancellor thinks that the extra relief proposed in Clause 43 helps to make prospects more attractive. So there should be a general effect of encouraging more UK residents to work as seafarers. The Chancellor does not believe that can be as unhelpful as the GCBS claim.

I am copying this letter to Simon Whiteley in the Department of Transport.

Yours,
James

S M A JAMES
Private Secretary





Treasury Chambers, Parliament Street, SW1P 3AG
071-270 3000

PRIME MINISTER

MERCHANT SHIPPING AND DEFENCE

... I attach a paper prepared by officials in the Ministry of Defence, the Department of Transport and my Departments to meet your request for an analysis of the case for additional help for merchant shipping and of the options for providing it.

2. Let me say first that I hope we are all agreed that the case for any additional help stands or falls on the defence argument. There is no economic argument for treating shipping as an exception to our policy of helping industry by creating a generally favourable climate rather than by special subsidies. Any further measures which are taken must be capable of being ring-fenced by the defence argument.

3. The paper confirms me in my view that, even if action is required, fiscal measures are not the way forward. The detailed analysis of options brings out that there is nothing that can be done via the tax or contribution systems that cannot be done more directly - and more cost-effectively - by a subsidy or grant; and that the "fiscal" options have no advantages and some real disadvantages compared with the expenditure options. (It is also worth stressing that at least one of the CGBS "tax" options would actually count as public expenditure and the House Authorities advise it could not be introduced via a Finance Bill).

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4. Officials have not attempted to reach an agreed position on the strength of the case for action. I am not sure that we are in a position to do so. It must always be the case that we will be unable to meet all possible needs for defence or civil resupply. I accept that, with the decline in the Merchant Fleet, the risks must be increasing. But I believe we still lack any clear view of precisely what the risks are at present, or of the extent to which they could be reduced by expenditure of any given sum.

5. There is a difficult balance to be struck here which could only be properly resolved by more detailed analysis. Even then, these can only be matters of judgement and I remain sceptical. But I must record that, in accordance with our agreed policy on public expenditure, any funds for additional help for shipping should be found from within existing provision. If Tom and Malcolm wish to take this further, therefore, it should be on the basis that they are prepared to give it priority within their existing programmes.

6. Copies to Tom King, Malcolm Rifkind, Peter Lilley and Sir Robin Butler.

A handwritten signature in blue ink, appearing to be 'N.L.' with a flourish.

[N.L.]

25 June 1991

MERCHANT SHIPPING AND DEFENCE

Paper by Officials

Summary

1. In times of war or crisis, merchant shipping is needed both for military purposes and for civilian resupply. Foreign flagged ships may be chartered if available, but only British-flagged ships may be requisitioned under the Royal Prerogative. Foreign crews may refuse to serve in war zones.
 2. At present, it is just possible to meet our defence needs with British flagged ships or the NATO pool. Further decline in the Merchant Fleet could make it impossible for us to run a Falklands type operation or to fulfil our NATO role in Europe.
 3. There is no economic case for special help for shipping, though Ministers may see a political case.
 4. Special tax measures to help shipping were included in the 1988 and 1991 Budgets. There are also a variety of small Government grants to encourage UK crewing.
 5. If it is decided that action is needed, the main options to help maintain the size of the UK flagged fleet are:-
 - a. to contract with ship-owners to make particular ships available for defence purposes;
 - b. to introduce (i) an investment grant or (ii) an enhanced depreciation allowance for ships brought on to the register.
- (a) would discourage flagging-out; (b) would bring more ships on to the register. All three options
- could be difficult to target, in part because of uncertainties about what precisely will be needed in any future crisis;

- would have deadweight costs (large for (b)(i) and (ii)) in subsidising ships which would have been on the register anyway;
- would distort ordinary commercial judgements, almost by definition;
- could be roughly comparable in terms of cost to achieve a given result: perhaps £100m a year to produce a significant impact (though (a) could be significantly cheaper if well-targeted);

The fiscal option (b)(ii) would be most difficult to target. The contract for availability (a) would be easiest to ring-fence: the other options would certainly encourage requests for comparable concessions from other industries.

5. The most straightforward option to encourage British crewing would be an operational subsidy reflecting the difference in costs between British and foreign crews. Action through the tax or National Insurance systems could achieve the same effect but in a more complicated, patchier and less transparent way, with a higher risk of unwanted side effects or of setting an undesirable precedent. The contract option at 5(a) could also be tied to British crews.

6. There is no scope for further relaxation of the requirements for British registration beyond measures already in train.

7. Legislation to make requisitioning ships easier would be a nil cost option, but could be controversial and would not guarantee British crews.

8. Negotiations continue on international agreements, but these are unlikely to be of any substantial value in the event.

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DEFENCE NEEDS AND MERCHANT SHIPPING

Paper by Officials

This paper examines the defence case for providing Government assistance to the UK merchant shipping industry in the light of the continuing reduction in size of the UK fleet, and discusses options.

Defence needs

2. Merchant shipping is required in crisis and war for support of the military, and for civil resupply of the UK. In principle, all British flag ships (ie UK, Isle of Man and Dependent Territories) could be requisitioned under the Royal Prerogative in the event of a threat to the realm. These and other UK owned but non-British flagged ships could be requisitioned in crisis and war situation with or without a threat to the realm if Emergency Powers are taken.

3. There is also a requirement for British seafarers, as foreign nationals are often unwilling to sail into war zones. In general, UK flag ships are more likely to be British crewed. UK owned ships which are flagged out may only have British officers and would therefore need to have their crews replaced if they were requisitioned in a crisis.

Scenarios

4. The numbers and types of ships needed will vary according to the type of conflict and, in the case of a large scale war, would vary with each stage. Current NATO planning caters for a full-scale war with the Soviet Union. In such an event, merchant ships would be needed for sea-lifting US equipment across the Atlantic, for UK forces reinforcing Europe, for direct support of the Royal Navy, and for civil resupply of the UK.

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5. A recent UK study of the supply and demand of shipping during the tension phase of this scenario showed a shortfall of UK flag vessels for military purposes of:

35 Roll-on/Roll-off ferries (Ro/Ros)
13 General cargo vessels
4 Product tankers

with a much higher shortfall for civil trade. In later phases of the war the military requirements would reduce but a shortfall of around 30 Ro/Ros and 70 general cargo UK flag ships would remain, mainly for civil resupply. This shortfall would have to be met from NATO's pooling arrangements for merchant shipping.

6. Although NATO planning continues to take account of the potential USSR threat, future concepts of operation are likely to be based on more flexible, rapid deployment of forces. Quantification of shipping requirements is not possible at present. Civil resupply is likely to be of less importance, but there could be an increased military need for shipping in support of UK forces' rapid deployment into Europe. It is unlikely that the requirement would be less than that in the present plans for UK reinforcement of Europe, for which there is a shortfall of 12 UK flag (or 7 British flag) Ro/Ros. There would also be a shortage of UK flag product tankers to support the Royal Navy.

7. The other type of defence need is the UK-only Out of Area Operation, in which co-operation of NATO allies cannot be assumed. There are just enough British flag ships to repeat the Falklands for example, but this would severely disrupt the British shipping industry. There were no problems in meeting our shipping needs for the Gulf, but that was a unique occasion where, in support of a UN Resolution, we were able to charter foreign ships for purely logistic operations with minimum enemy risk.

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The Economic Argument

8. The General Council for British Shipping (GCBS) has also argued that there is an economic argument for special help for shipping, as an important industry making a valuable contribution to the balance of payments. But no case has been made for treating shipping as an exception to the general Government policy that subsidises for single industries are justified only in cases of market failure.

9. Mr Rifkind and Mr King, in their minute to the Chancellor of 29 May, further argue that the British Merchant Fleet is seen by the public as a vital national asset so that a continued flight from the British flag could be politically damaging.

Is Action Needed?

10. If the size of the UK flag fleet remained at present levels we could meet defence requirements - but probably not civil resupply - under most scenarios if numbers were supplemented by other British flag ships. But the UK flag fleet is declining: the total number of trading ships (ie those which are useable in times of war) has fallen in the last four years, from 709 to 521 (8.5m to 4.1m deadweight tonnage). This trend is likely to continue. P&O, in particular, are considering further flagging out and others would follow.

11. There are also problems in maintaining the level of British and Irish seafarers. A recent study suggested that, with an unchanged world fleet size, 1800 new seafarers are needed every year until the year 2000 to maintain the existing levels of UK and Irish manning per vessel. Current annual recruitment level is about 700.

PRESENT AIDS TO SHIPPING

12. In line with general industrial policy, the UK shipping industry benefits from low general rates of taxation. There are

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also a few tax measures - total cost about £45 million a year - targeted at shipping, though not necessarily with the objective of meeting the defence need.

13. The main measure of assistance is foreign earnings deduction (FED). UK taxpayers working overseas are generally exempt from tax on their overseas earnings if they are away from the UK for a period of one year or more. The qualifying period can include up to 62 intervening days spent in the UK.

14. For seafarers the limit was increased to 90 days in 1988 and is being increased again to 183 in the current Finance Bill, increasing the cost of the measure from £20 million a year to £30 million. The increased limit is intended to assist recruitment and retention of UK seafarers particularly in deep sea trades. FED is not confined to seafarers on British flagged ships.

15. The other measures of support include: the availability of relief under the Business Expansion Scheme, with more generous rules including a special £5 million limit (other business have a ceiling of £0.5 million on the amount they can raise through the scheme) at a cost of some £5 million a year; and small subsidies - totalling about £10 million a year - to help with the costs of training, of transporting crews to and from ships in distant waters and of maintaining a reserve of ex-seafarers.

16. The Government is also taking steps - in line with general policy - to deregulate the shipping industry as far as is compatible with safety requirements, defence needs and international obligations. Action is in hand to implement all the recommendations of a joint Government/Industry working party established last year to identify the main obstacles to competitive use of the British flag.

OPTIONS FOR FURTHER SUPPORT

17. Options for further support can conveniently be categorised by their objective as measures intended to maintain the size of the UK flagged fleet, or measures to encourage the use of British

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crews. A range of possibilities are described and appraised below.

Maintaining the size of the UK flag fleet

(a) Enhanced depreciation for investment in new and second hand ships brought onto the UK register (GCBS asked for 100 per cent allowance in 1991 Finance Bill).

Effectiveness. Would encourage additional investment in UK shipping but not UK registration, unless deregistration penalties were to apply. (But that would breach the EC Treaty). Not targeted. High deadweight: would assist investment which would occur anyway.

Cost. Average £150 million a year in deferred tax over five years if current level of investment doubled. Deadweight cost (ie cost of allowance for investment already planned) would be high (£100 million in first year).

Comments. Represents a reversal of current policy. Would generate widespread "me too" claims from other industries.

(b) Roll-over relief to allow proceeds of sale of ship to be held untaxed for investment in subsequent years.

Effectiveness. Would not encourage flagging-in. Not targeted. Only applies where ship replaced so incentive to modernise but not to increase tonnage.

Cost. £30-50 million a year in tax (1990 estimate), with significant deadweight element.

Comments. GCBS are not asking for this, although it was the subject of new Finance Bill clauses in 1989 and 1990. Amounts to the reintroduction of first year allowances for the replacement ship, so shares same problems. Would also benefit existing companies at the expense of potential recruits.

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(c) Grants for investment in new or second hand ships brought on to UK register.

Effectiveness. High if targeted accurately on ship types. But this would be difficult, so could end up with too many (in the commercial sense) ships of one type which also have limited defence use.

Cost. Hard to assess. Say, £50-100 million a year if investment doubled and grants of up to 10 per cent of purchase price were available.

Comments. Investment grants were available in UK in late 1960s. Would confine benefits to shipping area of business. Risk of "me too" claims, although this would be less than with fiscal measures as the link with the defence need could be more readily established.

(d) Contracts with shipowners to make available for defence purposes specific, British crewed, UK flagged ships.

Effectiveness. Could be high if contracts could be targeted on scarce vessel types. Could also be linked with a requirement to employ UK seafarers. But there would inevitably be some deadweight cost.

Cost. Difficult to quantify. Cost penalty of operating ships with British crews under the UK flag of the order of £200,000 a year per ship for many vessel types. Cost of contract scheme would depend on number of ships to be covered.

Comments. Idea was dropped after 1988 Cabinet discussions, in favour of FED concession. (At the time, GCBS were pushing for tax concessions.)

(e) Creation of a reserve merchant fleet.

Effectiveness. High.

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Cost. Very expensive, eg 30 second hand Ro/Ros would cost £750 million.

Comments. Impossible to justify on value for money grounds. Difficult to operate reserve fleet commercially until needed if built to military specification.

(f) Further relaxation of regulatory requirements on British shipping.

Comments. Little further scope for action. Could even be counterproductive if it removed the main perceived advantage of British flagging - our comparatively high standards.

Encouraging employment of British seafarers

(a) Extension of existing subsidies for operating costs of UK flag ships.

Effectiveness. Present assistance with training costs of officer cadets effective in boosting recruitment, which increased from 162 in 1987 to 525 in 1990-91. Well targeted. Impact of crew relief costs support less certain, but take-up rate is high. Marginal return to further spending on either of these is thought to be low.

(b) New subsidy to cover some or all of additional costs of employing UK crews.

Effectiveness. High

Cost. Up to about £70 million a year.

Comment. EC guidelines on state aids to shipping allow substantial scope for support, mainly because of the Commission's wish to foster an EC fleet crewed by EC nationals. Guidelines allow support based on the difference in operating

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costs and tax between the lowest EC level - currently Portugal - and those of the open flag registries.

(c) Repayment to ship-owners of seafarers' income tax and employers' national insurance contributions (other GCBS proposal in the 1991 Finance Bill but, in effect, a subsidy).

Effectiveness. Moderate. Would cut the costs of employing British crews by 20 to 30 per cent (GCBS estimate). Would also help to prevent flagging out, where this is done to keep down crew costs. But even with the measure, industry say foreign crews would be cheaper. Tax system inefficient mechanism for delivery of operating subsidy.

Cost. £45 million a year tax retained (£30 million income tax; £15 million NICS), which would score as public expenditure.

Comments. Outside scope of Finance Bill. GCBS earlier proposed abolition of income tax and NICS, which would have the same effect. Proposal excludes ships plying exclusively in inland waters.

LEGISLATION

18. Rather than provide assistance through the tax regime, subsidy or deregulation, the Government could widen its powers, eg to requisition ships, through legislation. Some options are discussed below.

(a) Extension of emergency powers, to allow requisition of (i) British flag ships for crises not involving defence of the realm and (ii) British owned, foreign flagged ships in any emergency situation.

Effectiveness. Limited. There is a traditional reluctance to invoke emergency powers too early, which means they may not be available until too late for them to have much practical effect.

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(b) Legislation giving standing powers to requisition British owned, foreign flagged ships.

Effectiveness. Limited. No guarantee that such ships would be British crewed.

Comments. Would dispense with need for emergency powers.

(c) Introduction of crew nationality regulations requiring British flag ships to employ British crews.

Effectiveness. Counterproductive: would create incentive to flag out.

Comments. Would be against general policy on deregulation. Could be in conflict with EC Treaty anti-discrimination provisions.

(d) Legislation to require British owned ships to be British registered.

Effectiveness. Unenforceable. Until 1988 British owned ships had to be British registered, but option of setting up foreign subsidiary was a way out.

Comments. Also discriminatory.

INTERNATIONAL AGREEMENTS

(a) Extension of present agreements with foreign states of registry not to prevent requisitioning of British owned ships under their flags.

Effectiveness. Limited. Agreement may not hold in the event.

Comments. Have agreements with Bahamas, Liberia and Vanuatu. Slow progress with other states, but negotiations continue.

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(b) Agreements with NATO allies to make available ships where there is a shortage under the British flag.

Effectiveness. Effective in limited circumstances: less effective in times of tension (when need is greatest).

Comments. Can obtain access by agreement to other NATO flag ships eg Dutch and Belgian Ro/Ros. But these countries also face problem of flagging out.

EXPERIENCE IN OTHER COUNTRIES

19. Most other major maritime states in the developed world offer significant support to shipping, primarily for economic reasons. Only the United States appears to give assistance aimed specifically at meeting defence needs. Under the US scheme, operational subsidy is available for US flagged and US crewed ships. This is designed to cover the difference in costs compared with flagging out and using foreign crews. Some US shipowners still prefer to go offshore. Provision for 1991-92: \$272 million.

EC dimension

20. Many of the options discussed here would be notifiable state aids, but EC guidelines on state aids to shipping allow substantial scope for support, mainly because of the Commission's wish to foster an EC fleet crewed by EC nationals. Guidelines allow support based on the difference in operating costs and tax between the lowest EC level - currently Portugal - and those of the open flag registries. Some of the options - directly linked to registration - might well be in breach of Treaty.

CONCLUSION

21. There is no clear "best buy" if Ministers decide action is needed, though certain of the options above can clearly be ruled out.

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22. If the main objective was to maintain the size of the UK-flagged fleet, the possible options would be to contract with ship-owners to make particular ships available for defence purposes or civil resupply, or to introduce an enhanced depreciation allowance or an investment grant for expenditure on new or secondhand ships to be brought on to the register. The first would discourage flagging-out; the other two would bring more ships on to the register. The first could be considerable cheaper - depending on the number of ships contracted for - than the other two options which might cost £100 million or so to make any real impression on the problem.

23. All three approaches have potentially high deadweight costs and, because defence needs change over time, all three would be difficult to target precisely. (Though fiscal approaches are always harder to target than grants). All three would be seen as a precedent by other industries and would be prayed-in-aid for special treatment: of the three, contracts to make ships available would be the easiest to ring-fence.

24. If the priority was to encourage the use of British crews, then a straight operating subsidy would be the most straightforward approach. Action through the tax or National Insurance systems would achieve the same effect but in a more complicated and less transparent way, with a higher risk of unwanted side effects or of setting an undesirable precedent.



10 DOWNING STREET
LONDON SW1A 2AA

From the Principal Private Secretary

6 June 1991

KW
c/pps/plaistow
COHMT
MoD
Tpt

GCBS FINANCE BILL PROPOSALS

The Prime Minister has asked me to thank you for your letter of 6 June. I have passed the material attached to it to the Treasury, Ministry of Defence and Department of Transport. The Prime Minister has asked the Secretaries of State for their views on the propositions you put to him when you came to see him.

ANDREW TURNBULL

The Rt Hon The Lord Sterling of Plaistow CBE

tw



KW

clpps/heywood

10 DOWNING STREET

LONDON SW1A 2AA

From the Principal Private Secretary

6 June 1991

GCBS FINANCE BILL PROPOSALS

When Lord Sterling came to see the Prime Minister recently, he disputed the estimates which the Prime Minister was using for the costs of the GCBS proposals. Lord Sterling has sent in the attached. The Prime Minister has asked for this to be circulated to you, Ministry of Defence and the Department of Transport.

I am copying this letter to Simon Webb (Ministry of Defence) and Simon Whiteley (Department of Transport).

ANDREW TURNBULL

Jeremy Heywood Esq
HM Treasury

tw

020
President :
The Rt. Hon. The Lord Sterling of Plaistow, CBE.

*Price Minimis
(unacknowledged and pass calculations
to Treasury, Transport, Defence)*
AT 5/6
General Council of British Shipping
30-32 St. Mary Axe
London EC3A 8ET
Telephone : 071-283 2922

John Major
6th June, 1991

The Rt. Hon. John Major, MP.,
Prime Minister,
10 Downing Street,
London, S.W.1.

GCBS FINANCE BILL PROPOSALS

At my meeting with you when we talked about the economy in general and my views on Japanese inward investment, we touched on the merchant shipping situation. You will remember that I was more than surprised at the cost of our proposals as quoted from your notes.

You kindly suggested that perhaps I might forward our views on these figures. We have now reviewed them and you will see that in our view the cost will be much lower.

The estimate for the income tax/national insurance measures broadly tallies with our own, but the capital allowances would cost much less - we estimate £36 million in year one and, on average, between £37 million and £46 million per annum over the five years, depending on whether orders went up by 50% or 100%. Even on the crudest basis of tax deferred in 1991/2, the cost would be under £130 million. The figures take no account of tax payable on the sale of replaced vessels, nor of the tax paid on the increased profits from a modernised and enlarged fleet.

Our detailed calculations are attached for your reference.

It is worth remembering that these fiscal proposals were not put up as a normal industry lobby but as the final part of the exercise following the findings of the Joint Working Party. You might remember, when the original Joint Working Party was set up at a meeting between you, Cecil Parkinson and myself in May of last year, it was your wish that such proposals were handled in this way. As you know, the findings of the JWP were unanimous in recognising the strategic need of a Red Ensign fleet manned by British seafarers.

As, unfortunately, the original presentation to you had to be cancelled because of the hostilities in the Gulf, I would be very willing to run through the relevant slides which clearly identify the problem.

I have enclosed extra copies of this letter in case you wish to circulate it to relevant colleagues.

John Major



COST OF SHIPPING PROPOSALS

1. The figures quoted by the Treasury for the cost in the first full year of the package proposed by GCBS are £75 mn on income tax/national insurance and £260 mn on capital allowances - totalling £335 mn. We believe that these figures are taken from early GCBS calculations and may not represent a full appraisal by the Inland Revenue of the tax impact of the proposals. We believe that the direct cost would in practice be much less. The real cost of capital allowances, in particular, is likely to be in the order of £36 mn in year one.
2. Our cost estimate for the income tax/national insurance measures was in the range of £60-70 mn per year, for 16,000 officers and ratings. Bearing in mind that we know that there are some officers outside our ken, we agree that Treasury estimate for seafarers' tax and NI is broadly accurate.
3. It should nevertheless be borne in mind that, in the absence of Government action to stimulate the employment of British seafarers, certain inevitable consequences will follow. There will be a further decline both in the numbers of available British seafarers as they are replaced by lower-cost crews and - most importantly - in the recruitment and training of seafarers for the future. Moreover, there will - as a result of the measures proposed in Section 43 of the Finance Bill - also be an increase in the numbers of British nationals obtaining employment in deep-sea trades on foreign controlled ships, as they seek to take advantage of the tax exemption. Thus, the tax-payer will suffer in two ways. The income currently derived from the income tax and national insurance contributions of those who will no longer be employed in this country will be lost entirely. Secondly, the nation will no longer have the benefit of an adequate strategic reserve of qualified seafarers for defence purposes.
4. The estimation of the cost of a 100% ship allowance is more complex. It is important to note that - like any regime of tax allowances - the GCBS proposal does not create an exemption from corporation tax, but simply alters the time-profile by which tax is paid. Tax lost in year one is not tax lost for ever; it is payable in subsequent years after the allowance is used up. For this reason, it is misleading to isolate the cost in year one on its own. There are several factors which indicate additional tax revenue to Government, both in year one and subsequently, which would reduce the overall cost.

General Council of British Shipping

30-32 St Mary Axe London EC3A 8ET Telephone 071-283 2922 and 071-626 8131

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5. The GCBS estimate is that the tax revenue deferred as a result of a 100% allowance in year one is likely to be under £130 mn on the basis of a 50% increase in orders. This is based on the calculations and assumptions set out in Annex 1. The calculation takes no account of tax payable on the sale of replaced vessels or of cases where the effective rate of taxation for a particular company is below the nominal rate of 33%.

6. However, the cost of deferring the payment of tax is quite small. It can be calculated on the basis suggested in the GCBS December submission on fiscal issues, produced following the report of the Joint Government/Industry Working Party at the suggestion of the Prime Minister (then Chancellor). That estimated that the cost in NPV terms of this tax deferral at the then nominal rate of 35% was equivalent to a 6% discount on the capital outlay. At the new nominal rate of 33%, the corresponding figure is 5.5% - details set out in Annex 2.

7. If one looks at a five-year picture, assuming a 50% increase in orders over that time, the net cost to Government on this basis would be in the order of:

1991	£36 mn
1992	£27 mn
1993	£33 mn
1994	£44 mn
1995	£44 mn.

8. Even assuming a 100% increase from 1992 onwards (ie close to the target of £1-1.3 bn per year of new shipping investment GCBS has suggested is required), the net cost would be in the order of:

1991	£36 mn
1992	£34 mn
1993	£43 mn
1994	£59 mn
1995	£59 mn

9. Failure by the Government to take action to replenish our fleet will also have a number of inevitable economic consequences. In practice, the present tax revenues from shipping operations in the UK will diminish as the fleet contracts further. On the other hand, the opportunity of increasing tax income from its present levels, through the success which will follow the new investment, will be lost.

10. The modest cost of the proposed ship allowance would be more than offset both by the increase in income generated by the expanded British fleet and by its value to the nation in wider terms - in boosting the importance of the maritime-related activities of the City of London and in securing the nation's strategic defence objectives.

COST OF 100% SHIP ALLOWANCE

Background and Assumptions

1. The Treasury estimate of the cost of a 100% ship allowance appears to draw directly on the GCBS submissions on fiscal issues of December 1989 and 1990. These contained cost figures derived - using different starting points but essentially the same processes - from a straightforward analysis of the cashflow differential between the present, standard 25% writing down allowance and the proposed 100% ship allowance. On the basis of new shipping investment of £1 bn per year (as estimated by GCBS to be required for a limited period, to renew the UK's merchant fleet), they showed a first-year figure of £260 mn.
2. The December 1989 submission stressed the caveat that the cost was difficult to quantify with close accuracy. The December 1990 submission refined the analysis and calculated the impact on overall tax revenues by assessing the cost (net present value) of the tax deferral implied by a 100% ship allowance. This paper takes that analysis further in a practical way using real-world assumptions relating to 1991.
3. It is over-simplistic merely to take and extrapolate on the cashflow differential as actual cost. It represents, rather, the maximum outside cost on the basis of an estimated total investment equivalent to £1 bn. Specifically:
 - it fails to take account of the tax payable subsequently when the full allowance has been used up. In the case of a 100% ship allowance, that could apply from year two;
 - it assumes that the investment in year one will be at the full level;
 - it assumes that all expenditure relating to the investment will actually be incurred during that year;
 - it assumes that all companies investing will in practice be able to take full advantage of the new allowance in year one.
4. Actual qualifying expenditure on new and second-hand ships is likely to be substantially less. We know that:
 - in 1989, £190 mn was spent on new and £123 mn on second-hand ships (DTP figures), totalling £313 mn;
 - in 1985-9, the average expenditure on second-hand ships was £149 mn and represented about 43% of the total expenditure in new and second-hand ships (DTP figures);
 - in 1990, about £157 mn was spent on new ships. With the average levels of second-hand purchases for the last five years (£149 mn) this produces a figure again around £310 mn (GCBS estimates);

- the 31 March 1991 order book of 43 ships worth £730 mn will be delivered as follows:

1991 - £390 mn
1992 - £160 mn
1993 - £180 mn (GCBS estimates).

Cost in the Current Year

5. On the basis of present order book levels and the 1985-9 average expenditure on second-hand ships, the projected expenditure by UK shipping companies in 1991 is as follows:

Current orders: $\frac{1}{2}$ payment due on 1991 deliveries	£195 mn
Current orders: $\frac{1}{4}$ payment due on 1992/3 deliveries	£85 mn
1991 new orders: $\frac{1}{4}$ payment due on assumed 1991 level of deliveries	£98 mn
1991 second-hand ships: assumed 1985-9 level of purchases	£149 mn
	<hr/>
	£527 mn
	<hr/>

(The calculations take the calendar year as a reasonable proxy for the fiscal year. They also assume that stage payments are made, on average over a building period straddling three accounting years at $\frac{1}{4}$ in year one, $\frac{1}{4}$ in year two and the remaining $\frac{1}{2}$ in year three).

6. It might be reasonable (but probably optimistic) to assume that a 100% ship allowance will stimulate an immediate increase in orders and purchases by 50% above the levels assumed in paragraph 5. This would produce the following pattern:

Current orders, 1991 deliveries - as paragraph 5	£195 mn
Current orders, 1992/3 deliveries - as paragraph 5	£85 mn
1991 new orders - as paragraph 5 + 50%	£146 mn
1991 second-hand purchases - as paragraph 5 + 50%	£224 mn
	<hr/>
	£650 mn
	<hr/>

7. On this range of assumptions, the reduced tax take would be the difference between the amounts of depreciation deriving from these totals under the 25% writing down allowance and the 100% ship allowance respectively, multiplied by the effective tax rate. Assuming a 50% increase as in paragraph 6, at the nominal rate of 33%, this produces a reduced tax take in the order of £170 mn in 1991. This would apply if all companies were in a position to take up the 100% allowance. We know that this is unlikely, but we do not know to what extent. At a take-up of, say, 75%, the revenue deferred would be under £130 mn.

8. These estimates represent the most realistic case and refer only to year one. Three other factors are relevant, which emphasise the fact that the overall impact on tax will be even lower:

- .1 they assume that the tax lost in year one is tax lost forever. This is clearly not the case. It is a cost to Government only in deferred taxation, since it becomes payable in subsequent years. The real cost is therefore the net present value of the overall tax revenue over a longer period, which includes tax payable in subsequent years after the allowance has been used. The GCBS December submission contained an illustration of the impact on tax revenues over a 12-year ownership period (using assumptions of a 10% pre-tax rate of return, 8% discount rate, 5% inflation rate, and that all tax allowances were utilised as soon as possible). At the new nominal rate of corporation tax of 33% this produces a cost in NPV terms equivalent to a 5.5% discount on the capital outlay. At the levels of investment given in paragraph 6, the net cost to Government would therefore be somewhat under £36 mn;
- .2 no allowance has been made for profit on the sale of replaced vessels, which would provide additional taxable revenues;
- .3 the effective rate of taxation will depend on the practical circumstances of each company and may be significantly below 33%. The practical effect on Government revenues of an improved ship allowance is likely to be reduced in circumstances where there are insufficient excess taxable profits over and above the amount necessary to offset Advance Corporation Tax.

Cost in Subsequent Years

9. If one looks at a five-year period, it is less easy to predict the level of new acquisitions. It could be that new investment would stay at the enhanced levels in paragraph 6. However it is equally possible that, from 1992 onwards, investment would be double that at present, ie close to the target of £1 - 1.3 bn per annum of new shipping investment GCBS has suggested will be required to renew the fleet. Assuming full take-up, the effect on tax revenues of these two scenarios would be (£ mn):

	1992	1993	1994	1995
Present levels + 50%	140	191	143	130
Present levels + 100%	198	278	233	219

10. Extending the analysis in paragraph 8.1, the real cost over the 12-year ownership in npv terms for the investment in each of these future years would be (£ mn):

	1992	1993	1994	1995
Investment at present levels + 50%	495	600	809	809
npv in investment year	27	33	44	44
Investment at present levels + 100%	619	780	1078	1078
npv in investment year	34	43	59	59

11. These costs would also be mitigated by the factors identified in paragraph 8 and may be considered as maximum likely costs.

100% SHIP ALLOWANCE: COST OF TAX DEFERRALS

1. The GCBS December submission on fiscal issues illustrated the impact of the tax deferral under a 100% ship allowance in terms of the net tax revenue from the ownership and operation of a new ship, both in cash and in net present value terms. It assumed that:

Original Cost	£40 mn
Resale after 12 years	£15 mn
Returns in quarter one of year one	10% pa
Growth in return (ie inflation)	5% pa
Discount factor	8%
Corporation tax	33%.

2. In arriving at a "taxable profit", it is assumed that for the first quarter of operations a taxable profit would be achieved equal to a 12-year annuity at an interest rate of 10% pa (ignoring any resale value of the vessel at the end of that period). For subsequent quarters, the profit from the previous quarter would grow at a rate of 5% pa (ie 1.25% each quarter).

3. The assumptions made about the level of "profit" do not affect the calculation of the benefit of 100% First Year Allowances compared with 25% Writing Down Allowances, but merely establish the absolute amount of tax that would be paid under both scenarios.

4. All calculations have been performed on the basis of investments being made mid-year (30 June) with tax payable nine months after the end of the year, ie tax paid 30.9.91 on profits made to 31.12.90.

5. Taxable profits are taken to be profits before depreciation. No allowance has been made for loan interest that might be payable on any borrowings taken to finance part of the investment.

Conclusions

Total Tax Paid Assuming		Present Value of Tax Paid Assuming	
100% FYA	25% WDA	100% FYA	25% WDA
£	£	£	£
22,751,691	22,751,691	7,075,098	9,271,327

The "saving" of tax in present value terms is:

<u>P.V. Saving</u> £	<u>Equivalent to Reduction in Original Cost of</u> %
2,96,229	5.49

6. The detailed calculations are attached.

RETURN 10.00% NPV OF TAX -9,271,326.50
 INFLATION 5.00%
 ALLOWANCE 25.00%
 TAX RATE 33.00%
 DISCOUNT 8.00%
 NPV CASH FLOW 13,695,624.39

25% WDA

QUARTER	CAPITAL EXPENDITURE	TAXABLE PROFIT	TAX ON CAPITAL ALLOWANCE	TAX ON PROFIT	NET CASH FLOW	NET TAX (PAID)/ RECEIVED
0	-40,000,000.00				-40,000,000.00	0.00
1		1,440,239.75			1,440,239.75	0.00
2		1,458,242.75			1,458,242.75	0.00
3		1,476,470.78			1,476,470.78	0.00
4		1,494,926.67			1,494,926.67	0.00
5		1,513,613.25	3,300,000.00	-956,499.23	3,857,114.03	2,343,500.77
6		1,532,533.42			1,532,533.42	0.00
7		1,551,690.08			1,551,690.08	0.00
8		1,571,086.21			1,571,086.21	0.00
9		1,590,724.79	2,475,000.00	-1,985,789.56	2,079,935.23	489,210.44
10		1,610,608.85			1,610,608.85	0.00
11		1,630,741.46			1,630,741.46	0.00
12		1,651,125.73			1,651,125.73	0.00
13		1,671,764.80	1,856,250.00	-2,086,956.28	1,441,058.52	-230,706.28
14		1,692,661.86			1,692,661.86	0.00
15		1,713,820.13			1,713,820.13	0.00
16		1,735,242.88			1,735,242.88	0.00
17		1,756,933.42	1,392,187.50	-2,193,276.97	955,843.95	-801,089.47
18		1,778,895.09			1,778,895.09	0.00
19		1,801,131.28			1,801,131.28	0.00
20		1,823,645.42			1,823,645.42	0.00
21		1,846,440.98	1,044,140.63	-2,305,014.20	585,567.41	-1,260,873.58
22		1,869,521.50			1,869,521.50	0.00
23		1,892,890.52			1,892,890.52	0.00
24		1,916,551.65			1,916,551.65	0.00
25		1,940,508.54	783,105.47	-2,422,443.93	301,170.08	-1,639,338.46
26		1,964,764.90			1,964,764.90	0.00
27		1,989,324.46			1,989,324.46	0.00
28		2,014,191.02			2,014,191.02	0.00
29		2,039,368.40	587,329.10	-2,545,856.15	80,841.36	-1,958,527.05
30		2,064,860.51			2,064,860.51	0.00
31		2,090,671.27			2,090,671.27	0.00
32		2,116,804.66			2,116,804.66	0.00
33		2,143,264.71	440,496.83	-2,675,555.65	-91,794.11	-2,235,058.82
34		2,170,055.52			2,170,055.52	0.00
35		2,197,181.22			2,197,181.22	0.00
36		2,224,645.98			2,224,645.98	0.00
37		2,252,454.06	330,372.62	-2,811,862.73	-229,036.06	-2,481,490.11
38		2,280,609.73			2,280,609.73	0.00
39		2,309,117.35			2,309,117.35	0.00
40		2,337,981.32			2,337,981.32	0.00
41		2,367,206.09	247,779.46	-2,955,114.03	-340,128.47	-2,707,334.56
42		2,396,796.16			2,396,796.16	0.00
43		2,426,756.12			2,426,756.12	0.00
44		2,457,090.57			2,457,090.57	0.00
45		2,487,804.20	185,834.60	-3,105,663.31	-432,024.51	-2,919,828.71
46		2,518,901.75			2,518,901.75	0.00
47		2,550,388.02			2,550,388.02	0.00
48		2,582,267.87			2,582,267.87	0.00
49	15,000,000.00		139,375.95	-3,263,882.37	11,875,493.58	-3,124,506.42
50					0.00	0.00
51					0.00	0.00
52					0.00	0.00
53			-4,531,872.15	-1,693,776.45	-6,225,648.60	-6,225,648.60
54					0.00	0.00
55					0.00	0.00
56					0.00	0.00
57					0.00	0.00
TOTAL	-25,000,000.00	93,944,517.68	8,250,000.00	-31,001,690.84	46,192,826.85	-22,751,690.84

RETURN 10.00% NPV OF TAX -7,075,097.53
 INFLATION 5.00%
 ALLOWANCE 100.00%
 TAX RATE 33.00%
 DISCOUNT 8.00%
 NPV CASH FLOW 15,891,853.36

100% FYA

QUARTER	CAPITAL EXPENDITURE	TAXABLE PROFIT	TAX ON CAPITAL ALLOWANCE	TAX ON PROFIT	NET CASH FLOW	NET TAX (PAID)/RECEIVED
0	-40,000,000.00				-40,000,000.00	0.00
1		1,440,239.75			1,440,239.75	0.00
2		1,458,242.75			1,458,242.75	0.00
3		1,476,470.78			1,476,470.78	0.00
4		1,494,926.67			1,494,926.67	0.00
5		1,513,613.25	13,200,000.00	-956,499.23	13,757,114.03	12,243,500.77
6		1,532,533.42			1,532,533.42	0.00
7		1,551,690.08			1,551,690.08	0.00
8		1,571,086.21			1,571,086.21	0.00
9		1,590,724.79	0.00	-1,985,789.56	-395,064.77	-1,985,789.56
10		1,610,608.85			1,610,608.85	0.00
11		1,630,741.46			1,630,741.46	0.00
12		1,651,125.73			1,651,125.73	0.00
13		1,671,764.80	0.00	-2,086,956.28	-415,191.48	-2,086,956.28
14		1,692,661.86			1,692,661.86	0.00
15		1,713,820.13			1,713,820.13	0.00
16		1,735,242.88			1,735,242.88	0.00
17		1,756,933.42	0.00	-2,193,276.97	-436,343.55	-2,193,276.97
18		1,778,895.09			1,778,895.09	0.00
19		1,801,131.28			1,801,131.28	0.00
20		1,823,645.42			1,823,645.42	0.00
21		1,846,440.98	0.00	-2,305,014.20	-458,573.22	-2,305,014.20
22		1,869,521.50			1,869,521.50	0.00
23		1,892,890.52			1,892,890.52	0.00
24		1,916,551.65			1,916,551.65	0.00
25		1,940,508.54	0.00	-2,422,443.93	-481,935.38	-2,422,443.93
26		1,964,764.90			1,964,764.90	0.00
27		1,989,324.46			1,989,324.46	0.00
28		2,014,191.02			2,014,191.02	0.00
29		2,039,368.40	0.00	-2,545,856.15	-506,487.75	-2,545,856.15
30		2,064,860.51			2,064,860.51	0.00
31		2,090,671.27			2,090,671.27	0.00
32		2,116,804.66			2,116,804.66	0.00
33		2,143,264.71	0.00	-2,675,555.65	-532,290.93	-2,675,555.65
34		2,170,055.52			2,170,055.52	0.00
35		2,197,181.22			2,197,181.22	0.00
36		2,224,645.98			2,224,645.98	0.00
37		2,252,454.06	0.00	-2,811,862.73	-559,408.68	-2,811,862.73
38		2,280,609.73			2,280,609.73	0.00
39		2,309,117.35			2,309,117.35	0.00
40		2,337,981.32			2,337,981.32	0.00
41		2,367,206.09	0.00	-2,955,114.03	-587,907.94	-2,955,114.03
42		2,396,796.16			2,396,796.16	0.00
43		2,426,756.12			2,426,756.12	0.00
44		2,457,090.57			2,457,090.57	0.00
45		2,487,804.20	0.00	-3,105,663.31	-617,859.11	-3,105,663.31
46		2,518,901.75			2,518,901.75	0.00
47		2,550,388.02			2,550,388.02	0.00
48		2,582,267.87			2,582,267.87	0.00
49	15,000,000.00		0.00	-3,263,882.37	11,736,117.63	-3,263,882.37
50					0.00	0.00
51					0.00	0.00
52					0.00	0.00
53			-4,950,000.00	-1,693,776.45	-6,643,776.45	-6,643,776.45
54					0.00	0.00
55					0.00	0.00
56					0.00	0.00
57					0.00	0.00
TOTAL	-25,000,000.00	93,944,517.68	8,250,000.00	-31,001,690.84	46,192,826.85	-22,751,690.84

MEETING RECORDED

SUBJECT U MASTER.



file 5LW
(Company / Shipping)

10 DOWNING STREET
LONDON SW1A 2AA

From the Private Secretary

4 June 1991

SHIPPING

Jonathan Sayeed, MP, came in to see the Prime Minister this afternoon about the shipping industry. The Prime Minister had a brief from the Department of Transport for which he was grateful and had of course seen the recent exchange of Ministerial correspondence on the defence aspects of merchant shipping.

Mr. Sayeed set out the various figures showing decline in the merchant shipping fleet over the last 10 years. In his view this mattered for three reasons: economically, since shipping contributed some £3 billion to balance of payments. The GCBS asserted that they would be able to double this contribution in the right environment by the end of this decade (the Prime Minister said he was not familiar with this figure and I should be grateful for advice from the Department of Transport on the assumption that the GCBS used in arriving at this).

Second, there was the strategic argument. The Falklands engagement had been the last time when we could rely on the British merchant fleet and it was clear that flagged-out ships and other countries' crews would not serve in any future such conflict. The Prime Minister pointed out that they had been ready to do so during the Gulf conflict but accepted that that was conducted under UN auspices. Third, said Mr. Sayeed, there were the political implications of a continuing decline in the UK flagged fleet and in seafaring employment.

He supported the two GCBS proposals which are being discussed in the context of the Finance Bill. In his view, a hundred per cent capital allowances was the more important of the two since it would lead to improved investment and better use of merchant marine manpower. He also disputed the Treasury's figures for the costs of the two GCBS measures.

The Prime Minister said that P&O had made clear that a 100 per cent allowance would not have affected their decision. Mr Sayeed said that P&O was more diversified than other UK shipping lines. (Comment: I am not sure about this - Cunard is part of the Trafalgar House group.)

R

The Prime Minister said that it would be very difficult to consider a hundred per cent capital allowances for shipping and not for the whole of industry. He had been persuaded as a Treasury Minister of the economic arguments on the efficiency of investment against capital allowances and in favour of lower rates of corporation tax, since unlike lower taxes, high initial depreciation gave an artificial boost to marginal short term investment. He was not persuaded that such depreciation measures were the most effective answer within the shipping industry. He appreciated the strategic/defence concerns which Mr. Sayeed put to him. The Government did not have a wholly closed mind on the issue but if the need were identified for any further measures they would need to be cost-effective in addressing the problem and would need to be capable of being ring-fenced to the shipping industry.

Mr. Sayeed raised one other point which was his concern: that clause 43 of the Finance Bill, reflecting the budget changes, would, far from assisting the British fleet, actually further encourage its decline. This is because the extension of the period under which seafarers working mainly overseas can claim exemption from tax would encourage UK seafarers to move employment from the cabotage part of the industry to the deep sea merchant marine, most of which was flagged out. The Prime Minister made no substantive comment on that point though no doubt the Chancellor has considered this aspect made in the post-budget discussions with Mr Sayeed?

A copy of this letter goes to Simon Whiteley (Department of Transport).

(DOMINIC MORRIS)

Jeremy Heywood, Esq.,
HM Treasury.

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PRIME MINISTER

Jonathan Sayeed is coming in to see you tomorrow about shipping. He follows the P & O line so it will probably be a rehash of the comments you have already heard before from Lord Sterling.

The GCBS are continuing to press the two amendments they failed to get in the Budget, and the subject will come up in Standing Committee on the Finance Bill this week - probably tomorrow.

Jonathan Sayeed will probably express concern about the implications for defence, were current trends in flagging-out to continue. In recent Ministerial correspondence on this subject you have made clear you shared that concern, but have doubts about whether the measures suggested by the GCBS represent a cost-effective response. (You will recall that when Lord Sterling met you he conceded that the 100% depreciation proposal would not have had a significant effect on P & O's decision, though it might have been a bigger factor for some other companies.) The Chancellor of the Exchequer is strongly opposed to further action in this area, though he agrees that there should be an assessment of the need for a Government response and an evaluation of a more effective way of fulfilling any such need. But until that is done, his view is that we should hold the line that issues were carefully considered before the Budget and that we do not see any scope for further tax measures beyond the concessions announced there.

A fuller brief from the Department of Transport is attached.


DM

3 June 1991

jd a:sayeed

1. The General Council of British Shipping has regularly put Budget submissions to the Chancellor. These have generally been supported, behind the scenes, by the Secretary of State for Transport. At least one, minor, plea for "special case" treatment has been successful - under the Business Expansion Scheme the maximum that can be raised for shipping-related investment is £5 million instead of the usual £0.5 million and in 1986, 1-year ship charters were brought within the scope of the Scheme, which normally excludes such activities. In the 1988 Finance Act, provision was made to allow seafarers who stay in the UK for no more than 90 continuous days to recover the tax paid on their overseas earnings, a concession which is more favourable than for others who are allowed 60 consecutive days.

2. As current President of the GCBS, Lord Sterling embarked upon a high profile, face-to-face approach in the run up to this year's Budget. At the end of last year he gave a presentation on the shipping industry to the Chancellor of the Exchequer and various other Ministers. This focussed on the findings of the report produced by the Government/industry working party of which he was joint chairman with the Secretary of State for Transport ("British Shipping : Challenges and Opportunities" published 19 September 1990). Although fiscal measures were not included in the remit of the joint working party, Lord Sterling's presentation argued that such measures were essential to aid the industry and without which it would be unable to invest to replace the ageing fleet.

3. The GCBS made a formal submission to the Chancellor arguing for two fiscal measures:

- (i) for a "ship allowance" for the next five years whereby the whole value of a ship would be written off in the year of purchase or earlier during construction; and
- (ii) that shipowners be allowed in effect to keep the income tax paid by seafarers (so that they were paid net) and be relieved of employers' national insurance contributions.

They argued that a healthy and profitable shipping industry would ensure the availability of British flag merchant ships when needed for defence purposes.

4. There were also two GCBS inspired MORI polls in January/February, one of MPs and the other of the general public. The former indicated that about three-quarters would support action to encourage greater investment in merchant ships and the latter that 83% felt it was important that the fleet should not be allowed to decline any further.

5. An Early Day Motion was tabled by Jonathan Sayeed MP as part of the campaign. It called upon the Government to take immediate and positive action to stimulate investment and employment of British seafarers. This was signed by over 360 MPs.

6. The Chancellor of the Exchequer in his Budget speech on 19 March specifically mentioned the case put forward by the GCBS for

fiscal assistance for the industry. He acknowledged that there was a limit to the extent to which the tax regime could be manipulated to meet the special needs of any particular industry but, in recognition of the strategic case for encouraging employment of UK seafarers, he announced a further relaxation of the rules giving tax relief to seafarers working mainly overseas. This means that the period in which they can claim exemption from tax on their overseas earnings has been extended to 183 days per year. This means that more seafarers will be exempt from UK tax on their overseas earnings. The new limits applied from 6 April.

7. The GCBS are seeking two amendments to the Finance Bill covering their two suggested fiscal measures (above). Lord Sterling, as Chairman of P&O, has announced that in the absence of such measures his company will begin to flag out its fleet of 15 container ships. Immediately after the Budget, Cunard Ellerman and Blue Star flagged out four jointly owned container ships and P&O flagged out one.

500

MERCHANT NAVY

19:2:91

Mr Jonathan Sayeed
Mr Michael Mates
Mr Peter Shore
Sir David Price
Dr David Owen
Sir William Clark

★ 180

Rev. Ian Paisley	Mr Terry Dicks	Mr Jack Thompson
Mr Jim Sillars	Mr Geraint Howells	Mr Jerry Wiggin
Sir Geoffrey Johnson Smith	Mr William Cash	Mrs Irene Adams
Mr Roland Boyes	Mr Giles Radice	Mr Eric Illsley
Mr Ernie Ross	Mr Roger Sims	Mr Jim Marshall
Mr William McKelvey	Mr Peter Archer	Hilary Armstrong
Mr John McAllion	Mr Julian Critchley	Mr Alan Meale
Mr John Hannam	Sir Michael McNair-Wilson	Mr Eddie Loyden
Mr Richard Holt	Mr Ronnie Campbell	Mr Calum Macdonald
Mr David Trimble	Mr Jimmy Dunnachie	Mr Peter Hardy
Mr Patrick Thompson	Mr Robert Hughes	Mr Nicholas Winterton
Mr Churchill	(Aberdeen North)	Mr Alex Eadie
Mr Denzil Davies	Dr Michael Clark	Mr Frank Haynes
Sir Michael Shaw	Ms Dianne Abbott	Mr Terence L. Higgins
Sir Nicholas Bonsor	Mr Jim Cousins	Mr Conal Gregory
Mr Jonathan Aitken	Mr D. N. Campbell-Savours	Mr John Browne
Mrs Elizabeth Peacock	Mr Humfrey Malins	Mr Jerry Hayes
Sir Philip Goodhart	Mrs Ann Winterton	Mr Dick Douglas
Sir Giles Shaw	Mr Peter Rost	Mr Mark Wolfson
Mr Michael J. Martin	Mr David Tredinnick	Mr Harry Greenway
Mr Alan Haselhurst	Mr Jacques Arnold	Mrs Gwyneth Dunwoody
Mr John Townend	Mr Jack Aspinwall	Dame Peggy Fenner
Mr Alistair Darling	Mr A. Beaumont-Dark	Sir Charles Morrison
Mr John Wilkinson	Mr David Gilroy Bevan	Mr Bill Walker
Mr Gordon Oakes	Mr David Knox	Mr Colin Shepherd
Mr Tony Banks	Mr Bob Dunn	Mr Keith Vaz
Mr Neville Trotter	Sir George Gardiner	Mr Sydney Bidwell
Sir Anthony Grant	Ms Joyce Quin	Mr James Molyneaux
Sir James Spicer	Mr Dafydd Wigley	Mr David Madel
Mr Andrew Faulds	Sir Russell Johnston	Mr Richard Alexander
Sir Antony Buck	Mr Malcolm Moss	Mr Merlyn Rees
Mr Ken Livingstone	Mr Ian Bruce	Mr David Clelland
Mr Terry Davis	Mr Cecil Franks	Mr Paul Marland
Mr Charles Kennedy	Mr Nicholas Soames	Mr Richard Tracey
Mr Malcolm Thornton	Mr Hugo Summerson	Mr John Greenway
Mr Joe Ashton	Sir Neil Macfarlane	Mr Tim Ianman
Sir Richard Luce	Mr Menzies Campbell	Mr David Bellotti
Mr Rupert Allason	Mr Terry Patchett	Mr Ken Hargreaves
Dr John G. Blackburn	Mr Gerald Bermingham	Mr Robert Banks
Mr Tim Smith	Sir Gerrard Neale	Mr Andrew Hunter
Mr Andrew Rowe	Mr Roger Gale	Mr David Sumberg
		Mr Robin Maxwell-Hyslop

Mildred Gordon
Mr David Mudd
Mr Robert Boscawen
Mr Michael Morris
Mr Patrick Cormack
Sir Patrick McNair-Wilson

Mr Alex Carlile
Sir Julian Ridsdale
Mr John Home Robertson
Mr Kenneth Warren
Mr Hugh Dykes
Mr Barry Sheerman

Mr W. Benyon
Mr Norman Hogg
Mr Harry Cohen
Mr Archy Kirkwood
Mr George Walden

That this House welcomes the recent report of the Joint Working Party on British shipping published in September 1990; notes the vital importance of Britain's merchant fleet for the economy, employment and our strategic defences; recognises the links with regard to economic activity and maritime skills, between the merchant fleet and the marine related industries; notes that British shipping and those marine related industries together contribute some £5 billion a year to the country's trade balance, and calls on the Government to take immediate and positive action to first ensure that the British fleet is strengthened by appropriate stimulation of investment in modern tonnage and second encourage the recruitment, training and employment of British seafarers.



31/5

CF

DEPARTMENT OF TRANSPORT
2 MARSHAM STREET LONDON SW1P 3EB

My ref:

Your ref:

PSO/7185/91

Dominic Morris Esq
Private Secretary
10 Downing Street
SW1A 2AA

31 MAY 1991

Dear Dominic,

As requested in your letter of 28 May, I enclose a short briefing note which summarises the GCBS/Lord Sterling campaign for fiscal measures to support British shipping.

As you will know, my Secretary of State and the Defence Secretary have minuted the Chancellor of the Exchequer about the GCBS's case and I am enclosing a copy of that minute as additional background.

Yours ever,
Peter.

Peter McCarthy
Private Secretary

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CHANCELLOR OF THE EXCHEQUER

MERCHANT SHIPPING AND DEFENCE

You will recall that, before the Budget, we wrote to you individually, expressing our concerns about the possible consequences of not responding to the shipping industry's case for fiscal assistance.

Since the Budget, five container ships totalling some 150,000 tonnes have flagged off the mainland register. Four of these were jointly owned by Cunard Ellerman and there are worrying signs that their parent company, Trafalgar House, may be thinking about flagging out the remainder of its fleet. You will have seen P&O's announcement that they are "actively considering" flagging out their fleet. We have been told privately that, in the absence of fiscal concessions, P&O will flag out its container ships, which represent some 10% of the total trading tonnage on the UK register. The signs are that P&O will not stop there. There are indications that cruise ships will be next although, at least for the present, P&O seems to have no plans to flag out its ferries.

The number of ships available for defence needs is already at a critical threshold and could shortly be irretrievable. For example, a repeat of the Falklands action would probably take up all the British cruise ships operating this side of the Far East and Pacific, as well as five of the eight suitable British passenger Ro-Ros. If P&O was to flag out completely, the situation would become very grave indeed. Virtually all P&O

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ships have a potential military support role and without P&O we could not re-run the Falklands nor fulfil our NATO role in Europe. Moreover, we have little doubt that other British ship owners will be looking to P&O for a lead. If, for example, BP or United Baltic were to follow them, then other types of essential shipping for military support would also cease to be available for requisitioning under the Royal Prerogative.

It is, of course, true that Operation Granby was run successfully on the basis of chartering ships in the market place. But that involved a particular combination of favourable factors. It was endorsed by the United Nations and merchant shipping was asked to undertake only a logistical role. We have to consider future scenarios in which the United Kingdom may have little support world-wide (for example, the Indian Government forbade its nationals to take part in the Falklands operation) and where, as in the Falklands, merchant shipping has to undertake a dangerous, military role.

Also important is the need to ensure civil resupply of the United Kingdom. Recent studies have shown that in a major crisis there will be shortages of British flag merchant shipping. These will be at their worst in the period of tension preceding war, when there will be no effective controls on the utilisation of shipping capacity. Without adequate tonnage of our own we should have to rely either on ships put into the NATO pool by other nations whose priorities may be different from our own or hope that tonnage can be chartered in the market.

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We understand that the GCBS is working up a full analysis of the possible costs of the concessions they are seeking. Any such estimates would be for the Treasury, rather than our Departments, to comment upon and would necessarily be tentative. If your officials would find it useful to discuss any aspect of the calculations with ours, however, we would be happy to oblige.

Any support for the British shipping industry would need to reflect our objectives. Concessions on seafarers' taxation and employers' national insurance contributions directly affect the costs of operating a ship and would be the most relevant to retaining existing tonnage on the British register. Capital allowances, on the other hand, are relevant to investment in new tonnage although the level at which they might be set would need to reflect the degree to which we wish to encourage investment.

We would also need to consider more generally the conditions to be attached to any concessions. The priority would be to ensure that they went only to ships which remained available for defence purposes. British registration is a requirement of the Business Expansion Scheme arrangements for shipping and no doubt something similar could apply in the case of new fiscal support measures.

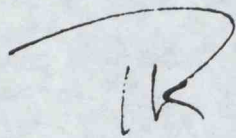
We have emphasised the importance of merchant shipping to defence and civil resupply but there is a wider sense, in which economic and political factors have an important part, in which the industry is a vital national asset; and is seen as such. A continued flight from the British flag would be very damaging in this wider context.

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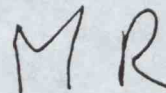
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Whilst there is a need to discuss the level and combination of concessions which would reverse the long standing trend to flag out, we have no doubt that something along the lines of what is proposed on capital allowances and on tax and insurance contributions is needed. In the circumstances, we would therefore ask you to reconsider this issue.

Copies of this minute go to the Prime Minister and to Sir Robin Butler.



TOM KING
Secretary of State for
Defence



MALCOLM RIFKIND
Secretary of State for
Transport

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TW

A. SAYEED

10 DOWNING STREET

LONDON SW1A 2AA

From the Private Secretary

28 May 1991

Jonathan Sayeed M.P. is coming in to see the Prime Minister at 1615 on Tuesday 4 June to discuss shipping matters. It will no doubt be a repeat of the lobbying which Lord Stirling has done. I should be grateful for a short briefing note dealing with the main points of that campaign.

Could I have this please by close of play on Friday 31 May.

DOMINIC MORRIS

Simon Whiteley, Esq.,
Department of Transport.

W



JOINT GOVERNMENT/INDUSTRY WORKING PARTY
ON BRITISH SHIPPING

FURTHER SUBMISSION
BY THE
GENERAL COUNCIL OF BRITISH SHIPPING
ON FISCAL ISSUES



**JOINT GOVERNMENT/INDUSTRY WORKING PARTY
ON BRITISH SHIPPING**

**FURTHER SUBMISSION
BY THE
GENERAL COUNCIL OF BRITISH SHIPPING
ON FISCAL ISSUES**

General Council of British Shipping

30-32 St Mary Axe London EC3A 8ET Telephone 071-283 2922 and 071-626 8131

Telex 884008 and 884768 SMA-G Facsimile 071-626 8135 (Group 3)

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JOINT GOVERNMENT/INDUSTRY WORKING PARTY
ON BRITISH SHIPPING

FURTHER SUBMISSION BY THE GENERAL COUNCIL OF BRITISH
SHIPPING ON FISCAL ISSUES

1. SUMMARY

1.1 The Report of the Joint Working Party⁽¹⁾ is a statement of the factual position of the shipping industry; unanimously agreed by the Department of Transport, the Foreign and Commonwealth Office, the Ministry of Defence, the Department of Trade and Industry and by the industry, with a Treasury observer participating.

1.2 The Report's principal conclusion is **"that British shipping is a vital national asset"**. The decision now for Government is how to retain and enhance the shipping industry, with ships under the UK flag and manned by substantial numbers of British seafarers.

1.3 The Report concluded that there are major commercial opportunities to be seized by British shipping. These will be greatly beneficial to the economic health of the country, and to the other maritime-related industries in particular, as well as to shipping itself. But it also makes clear that until the widespread support measures that other countries provide their merchant fleets can be swept away, British shipping will have an uphill task, even though it is lean and fit.

1.4 Shipping companies must make profits for their shareholders. They can do that in the UK or elsewhere, particularly where the cost and fiscal structure is more favourable, or indeed they can invest in other activities. The direct result of that would be that few, young, UK seafarers will either be needed or attracted. Training facilities will then shut. This would have serious implications for the maritime-related industries and, of course, for defence.

1.5 The regulatory changes proposed in the Report will be helpful. To implement them will require action by several Departments of State - the Ministry of Defence, the Foreign & Commonwealth Office and the Department of Transport - and a small amount of Parliamentary time. The shipping industry has already made a substantial commitment to recruit and train greater numbers of British seafarers.

(1) British Shipping: Challenges and Opportunities
HMSO September, 1990

1.6 **But more action is needed** - action to rebuild the fleet and to enable the recruitment and training of more, high quality British seafarers. The Report describes the wide range of fiscal advantages enjoyed by our competitors. Although it is obviously desirable that they should go, the Joint Working Party concluded that it is unrealistic to expect them to be removed in the next few years.

1.7 British seafarers are excellent. UK shipping companies naturally want to employ them. But British shipping faces some of the finest international competitors, many of whom have lower operating costs. To compete successfully, such costs have to be matched. Therefore to employ significant numbers of British seafarers they must be affordable. To make them affordable, the burden of **income tax and employers' national insurance contributions** should be removed from British shipping companies' costs.

1.8 British Shipping must rebuild its fleet to remain competitive. Flexibility in cashflow in an essentially cyclical industry is vital. **A 100% ship allowance** would provide it.

1.9 These measures should be reviewed after five years to assess their effect.

1.10 As clearly indicated in the Report, flagging out has taken place to a great extent. The Report also makes clear the commercial attractions of doing so. The regulatory and fiscal package could play a major role in stopping this process accelerating. As the Report states, **"a further decline of the Red Ensign fleet could be irreversible"**. This particularly applies to the liner and passenger trades, where the cost of entry is very high.

1.11 Given action to increase cash-flow flexibility and reduce crew costs, we predict a return of confidence, with more ships on the UK register and returning from abroad. The **£5 bn**, balance of payments contribution of shipping and the maritime-related industries in 1989 could reasonably be expected to reach **£10 bn** by the end of the decade. Such expansion would automatically provide the defence dividend of modern ships and trained British seafarers.

1.12 **THIS PACKAGE, TOGETHER WITH THE REGULATORY CHANGES RECOMMENDED BY THE JOINT WORKING PARTY, WOULD BE THE CATALYST FOR GROWTH AND WOULD BE AN ENACTMENT OF THE FINDINGS OF THE JOINT WORKING PARTY "THAT BRITISH SHIPPING IS A VITAL NATIONAL ASSET"**.

2. THE REPORT

2.1 The factual position of the British shipping industry has been clearly established in the Report of the Joint Working Party on the Merchant Navy, set up jointly by the Government and the British shipping industry in May 1990. The Joint Chairmen were The Rt. Hon. Cecil Parkinson, MP, the then Secretary of State for Transport and Sir Jeffrey Sterling, CBE, President of the General Council of British Shipping. The members of the Working Party included the Minister for Shipping and senior officials of the Department of Transport, the Foreign & Commonwealth Office, the Ministry of Defence and the Department of Trade Industry. GCBS was represented by its Vice-President and senior officials. A Treasury official was present throughout as a participatory observer. The Report of the Working Party was published on 19 September.

2.2 A key part of the Working Party's terms of reference was to produce an agreed factual account of the position of the British shipping industry, domestically and internationally. At the request of the then Chancellor, its remit did not include fiscal policy options, but GCBS was invited to make a further submission. Nevertheless, as part of the study of the factual position of the industry, it did consider the fiscal measures which have been adopted by our major trading partners and their impact on the UK's competitive position in shipping markets.

2.3 The Working Party concluded that: "British shipping is a vital national asset. After its years of contraction it is lean and fit. The industry is well placed to take advantage of the upturn in world trade, in the right conditions".

The National Interest

2.4 The Working Party also concluded that "it is in our national interest that British shipping should win profitable business. The Gulf crisis has brought back into sharp focus our defence needs for British ships and British seafarers. A strong, competitive British shipping industry is also good for the economy. Profitable investment on the upturn of world trade will benefit the balance of payments. It will create new jobs in seafaring and in landside investment. It will strengthen the country's position as a leading seafaring nation."

2.5 Important to our national prosperity are a number of marine-related activities in the City of London and elsewhere. To a greater or lesser extent there is a clear linkage between these activities and a prosperous domestic shipping industry. The Report states: "Such links are undoubtedly important. Some other countries - Norway and Greece in particular - regard the spin-off effects of a national fleet on domestic marine-related activities as a major determinant of policy. the supply of people with experience either at sea or in shipping companies is considered to be of critical importance for the competitiveness of some marine-related activities."

The Competition

2.6 The Working Party considered the measures which other countries had adopted to support their shipping industries. It concluded that: "there are important differences in the competitiveness of different national carriers which reflect more than just efficiency or skill differences. Differences arise because of the support which some governments provide. This can take the form of direct subsidy or support, or in some cases restricting market access to national carriers."

2.7 "In addition some governments encourage investment by individuals in shipping by offering them generous tax breaks. More recently some governments have also introduced measures to reduce the costs of employing national seafarers by granting relief on personal taxation and social security. These remove some or all of the burden of substantial on-costs for the employer, reducing the gap between Western and Third World crew costs. Such an approach has been broadly endorsed by the European Commission in their "Positive Measures" proposals for improving the competitive position for EC carriers. Some governments have also established so-called "international" or "second" ship registers which incorporate tax exemptions for national seafarers."

2.8 The Commission has also proposed a ceiling on Community governments' support to their shipping industries. This proposal was welcomed by the Joint Working Party: "as a first step towards the Government's aim of having aid within the Community levelled down and eventually eliminated". However, the Working Party concluded that: "while aid to shipbuilding has been steadily reduced, the elimination of aid to shipping is unlikely to be achieved in practice in the near future. The Working Party notes with approval the view of the Commission that Community shipping should be left in a position where it can compete with non-Community operators."

2.9 The Working Party came to the conclusion that early elimination was unlikely because of the wide range of reasons advanced by governments for supporting their shipping industry. These were in two main categories - defence and economic. The latter often included balance of payments considerations, prevention of exploitation of shippers by foreign-owned shipping; maintenance of maritime expertise and enabling national shipping lines to meet "unfair" competition from lower cost countries.

The value of UK registration, etc

2.10 "The Working Party considered the benefits to the UK of the different elements of a shipping activity - investment, commercial management, employment, technical operation, flag, etc - being retained in the UK rather than abroad. On the basis of five typical scenarios of a shipping operation the benefits were measured and as far as possible quantified under a number of headings - profit,

employment, tax revenue, demand for UK services, availability for defence. It is clear that the closer the connection with the UK the more the economic and other benefits associated with shipping returned to the nation."

UK seafarers

2.11 The Joint Working Party conclusions make it clear that the increased employment of UK nationals as seafarers is of major importance to the nation. In the first place the quality of UK officers in particular is one of British shipping's competitive advantages. In the face of world-wide shortages of trained and qualified officers, more must be employed if British shipping is to expand. Secondly, the value to the economy of a shipping industry is greater if it employs significant numbers of Britons rather than all foreigners. Thirdly, there are clear defence requirements for a pool of trained British seafarers. In a shooting war, neutral ships and seafarers would not be available. Fourthly, many marine-related activities require a supply of people with experience either at sea or in shipping companies to maintain their effectiveness. The report noted: "It is estimated that 1,000 officers are required each year by the marine-related activities, in addition to those required on shore by shipping companies. But the number of active British officers has fallen below 10,000 and their average age is increasing.About 45 per cent are now over 40."

2.12 The Joint Working Party concluded that: "high quality, well trained and well motivated seafarers will be essential if British shipping is to take advantage of the opportunities that are opening up." It noted that British companies have done much to revolutionise their industrial relations procedures and, with welcome Government help, to recruit and train officers. It also supported a five-point plan of the industry to take further action to increase the supply of trained seafarers.

2.13 But there is a major gap between the cost of employing a British crew and the cost of employing high quality seafarers from Eastern Europe and the Third World. The Joint Working Party showed that a British crew cost $2\frac{1}{2}$ times as much as various foreign crews. The use of the latter is an option which is available to British shipping companies if they flag their ships out. Many have already had no choice other than to follow that path. The Joint Working Party calculated the savings on a typical bulk carrier as being between £230,000 and £380,000 per annum.

2.14 We are not alone in this position. As the Working Party noted, other European governments face the same problems (which arise basically from the nature of developed economies) and some have recently introduced measures to reduce the costs of employing national seafarers in order to restore their competitiveness. Within the Community, Denmark, Greece and the Netherlands have already implemented favourable tax and social security arrangements for

seafarers. Germany and Spain are considering following suit. This approach has the endorsement of the European Commission. Sweden has taken similar action outside the Community.

2.15 Although UK wage costs are somewhat lower than in some Community countries, such as Germany and France, they are still above those of the Third World or Eastern Europe. Even though increasing worldwide shortages of junior officers make it imperative that UK companies train more British cadets, the substantial cost savings from the use of foreign seafarers cannot be ignored by companies engaged in most trades. Government action to reduce the cost of employing UK seafarers could therefore secure for the nation the reserve of skilled seafarers that are needed for defence purposes, and to provide expertise for the marine-related shore industries.

Irreversibility

2.16 Finally, the Joint Working Party took the view that: **"If the UK industry does not take this opportunity** [ie, that provided by the continuing expansion of world trade] **further decline may prove irreversible"**. This would be particularly the case in the liner trades, where sophisticated through-transport infrastructure and landside marketing and organisation is required as well as ships. The loss of the shipping leg would certainly lead to the loss of liner conference trading rights and market shares and may in time lead to the loss of the rest of the chain. These structures cannot be created or won back overnight, implying significant costs of re-entry.

2.17 Likewise, if demand for trained seafarers were to fall to very low levels because the ships were not there, training facilities might close and, once shut, would be difficult to reactivate. Even if reactivated, there would be a long lead-time before seafarers could complete their training. The higher the level of skill required, the longer the time needed to repair the skills deficit.

3. SUBSEQUENT DEVELOPMENTS

3.1 Since the Joint Working Party's report was completed in mid-September, the United Kingdom has entered the Exchange Rate Mechanism of the European Monetary System, thus accepting very significant constraints on the ability of the sterling exchange rate to fluctuate. The position has thus changed substantially since the view was taken by some economists that the balance of payments position was of little real economic consequence to the nation; they considered adverse balances would automatically right themselves under the influence of a fully floating currency. Whilst devaluation now will still be possible it will become a major political step. The value of industries such as shipping with a high and direct foreign exchange earning potential is thus enhanced. This value will be even more substantial when the maximum divergence spread for sterling in the ERM is reduced from 6% to 2½%, as is Government policy.

4. GOVERNMENT ACTION

4.1 The shipping industry is not a supplicant for help. The Joint Working Party concluded that it was a "vital national asset". It is for the Government to decide what action to take to preserve and enhance that asset. The proposals for regulatory changes put forward by the Joint Working Party are important. In the following paragraphs we put forward proposals for measures to enhance investment and the employment of UK seafarers.

4.2 This is the minimum package - together with the Joint Working Party proposals - that would be sufficient to influence commercial decisions favourably. UK owners would still not enjoy the same flexibility as many of our competitors. But we could live with that.

Investment

4.3 In the view of the industry the conclusions of the Working Party indicate very clearly that, without a modest measure of fiscal flexibility, the UK shipping industry is unlikely to be able to take full advantage of the opportunities before us. The expansion of world trade in the 1990s will provide great opportunities for profitable investment. The world fleet is ageing and is being replaced. We and our competitors are already building state-of-the-art ships, but the investment need is huge. The widespread support given to our competitors gives them too great an edge for British companies to overcome fully, however competent and dynamic they are.

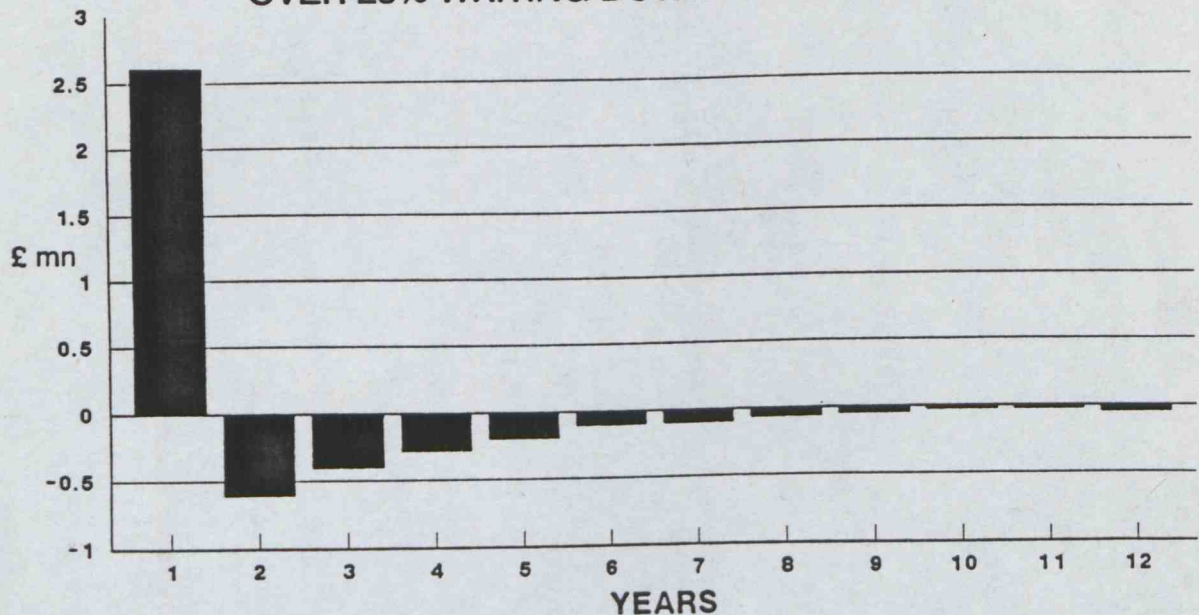
4.4 It is also clear that, although the option of flagging out ships and ship operations abroad exists and can provide an escape route for shipping companies, the advantage for the nation from having a shipping industry is greatly diminished if that route is followed. British shipping companies have the quality management to prosper either in shipping under a foreign flag or in non-shipping investments. The decision that the Government has to take is how to retain and enhance a UK-based shipping industry with ships on the UK register and manned by British seafarers.

4.5 The Joint Working Party concluded its work by making a number of recommendations for regulatory policy changes. The necessary legislation should be implemented this session. Time is not on our side. But on their own they will have only a limited impact on the size of the UK-registered fleet. The key to increased investment is a greater degree of fiscal flexibility to allow improved cashflow when it is needed most - on investing in new ships when the interest payments are highest.

4.6 By far the most efficient way of achieving this is to provide for accelerated depreciation. A 100% ship allowance would help the cashflow and make the rate of return on an investment in a new or good quality secondhand ship far more attractive. Shipowners need the ability either to write off all their investment in year one, or to spread it against years when sufficient profits are available. This includes the ability to write off stage payments for a ship under construction in the year that they are incurred, even if it has not yet been delivered. Of course, Group relief as at present would still be necessary.

4.7 The following graph shows the differences in cashflows from a 100% ship allowance compared with the present 25% writing down allowance arrangements. In net present values (assuming the Treasury's 8% discount factor) the introduction of a ship allowance would be equivalent to a 6% discount in the price of a ship. The practical benefit to a shipping company would be even greater as it would apply a higher discount factor in view of the risk element and the need to raise funds on the commercial market.

NET TAX CASH FLOW: ADVANTAGE OF 100% SHIP ALLOWANCE OVER 25% WRITING DOWN ALLOWANCE

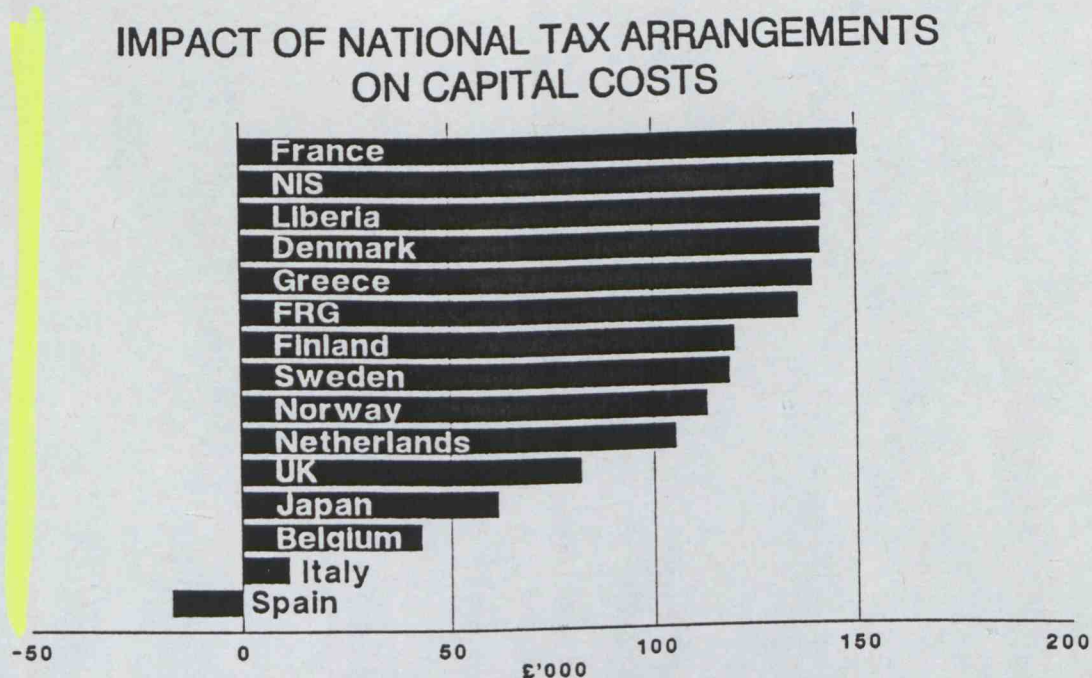


NOTE: NPV terms per £10mn invested (8% discount factor)

4.8 This would be the most cost-effective way of matching the range of measures other countries provide. Unless shipping companies invest in shipping, this measure will be cost-free. Introduced for a five-year period it would prime the pump for a rapid investment programme to restore and reinvigorate the merchant fleet.

4.9 The fear has been expressed in the past that a specific measure designed to stimulate investment in shipping could be misused to benefit foreign interests. Effective rules have been developed since 1982 which could be used again to prevent such misuse.

4.10 As can be seen from the following chart taken from the Joint Working Party Report, there is a long way to go before the position of other countries is reached, taking into account the range of aids made available to our competitors:



NOTE 1: Post-tax return for £1mn invested
Assumptions are: OECD terms of credit (80% of capital cost financed at 8% interest over eight and a half years), a 10% pre-tax rate of return, a discount rate of 8% and an inflation rate of 5%.

NOTE 2: The results shown in this chart do not take account of the tax reliefs to individual investors, or the tax and social security position of seafarers.

4.11 As Note 2 states, this chart does not take account of the very generous incentives offered in other countries to individuals investing in shipping, or the effect of other measures such as aid to crew costs or cabotage. But we believe that a 100% ship allowance would enable UK owners to compete against their highly subsidised competition.

Employment on-costs

4.12 The elimination of national insurance and income tax liabilities for seagoing employment would stimulate the employment of UK nationals. But it is vital for a mechanism to be incorporated to ensure that the benefit of any concessions feeds through to lower costs for the employer and that seafarers remain fully eligible for social security benefits, state pensions, the national health service, etc.

4.13 The current income tax regime for deep sea seafarers provides a welcome incentive for some seafarers to continue at sea. It also recognises the principle that the situation of seafarers requires special treatment. But only a small minority of seafarers - perhaps only 1% of those employed by UK companies - actually benefit. What is needed is an arrangement that suits the voyage patterns of most British seafarers and is certain enough to allow companies to negotiate lower pay rates and thus to benefit from lower costs. Many seafarers move from deep sea to short sea jobs and back again and it is unrealistic to have different tax and social security regimes for them. In contrast, the Danes exempt from tax all seafarers serving on the Danish International Register ships (90% of the total) who agree to work for a rate of pay equivalent to the normal rate of pay less the average rate of income tax, ie, a so-called "net pay agreement".

4.14 We propose, therefore, that:

- (i) instead of the current tax concession for seafarers, each night on board ship on a contract of employment providing for pay net of the standard rate of income tax should be tax-free;
- (ii) employers' national insurance contributions should not be payable for seafarers signed on such an employment contract.

4.15 This measure would cut about 25% off the industry's wage bill for British seafarers.

5. THE IMPACT ON TAX REVENUES

5.1 With the introduction of a 100% ship allowance there would be a deferment of tax on whatever level of investment would have taken place anyway. However, the gain would be the tax earned from additional investment stimulated by the relief and from the extra earnings of the maritime-related industries. For an individual ship, in cash terms, a ship allowance would affect the future profile of revenue flows rather than their quantum, with the costs of initial relief being balanced by greater corporation tax in subsequent years. But the overall tax revenue would be greatly augmented by the operating profits from large numbers of new, efficient ships.

5.2 If there is no investment in new ships, there will of course be no impact on tax revenues and the industry's taxable earnings will decline. Moreover, once operational, a new British-owned ship generates a substantial flow of income to the UK economy through salaries, operational expenditures and matters of that kind. As an example, the cost of insuring a new ship worth £40 mn is about £200,000 per annum.

5.3 To replace a fleet of the current size on a regular basis would require about 40 orders for new ships each year, varying in cost from £5 mn for a short-sea mini-bulker, £40 mn for a large deep-sea containership, to as much as £200 mn for a major passenger cruise-ship.

5.4 But a large part of the fleet must be replaced with new-generation ships if we are to match our competitors. The shipping industry is inherently cyclical in nature, particularly its building cycle, which leads to an irregular flow of profits. In investment terms, there is a need to anticipate the market, as once an opportunity has passed, it is lost until the next cycle. The industry is now faced with a particularly lumpy period of investment. Current levels of orders have to be accelerated. Hence we propose a ship allowance for five years to help the industry over the bulge.

5.5 As an illustration of the impact of this measure we show below the cash value and Net Present Value of the tax revenue over 12 years from the operation of a new ship costing £40 mn and sold for £15 mn (on the previous assumptions of a 10% pre-tax rate of return, an 8% discount rate, a 5% inflation rate, and assuming that all tax allowances can be utilised as soon as available):

	<u>Tax revenues over 12 years - £mn</u>		
	<u>25% WDA</u>	<u>100% Ship Allowance</u>	<u>Net Change</u>
Cash	24.1	24.1	-
NPV	9.8	7.5	-2.3.

There is thus only a cost in NPV terms equivalent to a 6% discount on the value of the ship.

5.6 These ships would be major and prolonged earners of foreign exchange. The industry and the maritime-related industries earned £5 bn in 1989, including import savings. This could reasonably be expected to reach £10 bn p.a. by the end of the decade. Although many of the new ships would be built abroad, they would be likely to be financed by foreign loans serviced by foreign currency earnings. Much of the equipment would be built in the UK and exported to the builders. There should be no great initial foreign exchange outflows. Neither would there be a real opportunity cost. Historically, there has been no shortage of investment funds around the world - only the absence of the conditions to make investment adequately profitable for UK shareholders requiring a real return on top of high national inflation levels.

5.7 The defence value of a healthy merchant fleet rather than a moth-balled reserve fleet can be shown dramatically. We have calculated the cost of buying secondhand the Falklands fleet of 53 ships compared with the cost of

requisitioning those ships for 90 days. On the best information available to us, it would cost the better part of £1 bn to buy and less than one-tenth of that amount to requisition. A Reserve Fleet would also have very substantial annual maintenance costs. The US Ready Reserve Fleet costs up to £1 mn per ship each year for maintenance and test reactivation costs. An active merchant fleet is kept fully operational by the commercial operator.

5.8 Of much greater importance is that a moth-balled fleet of ageing and obsolescent units cannot possibly be of the same quality as an active fleet of state-of-the-art ships. Above all, it would be extremely difficult to find competent crews. These ships would have to be manned with a mixture of reservists and those who could be recruited from the various agencies. Spare crews of active seafarers will not be available. Even if each reservist was given two weeks' training each year - and none is currently envisaged for the existing MN Reserve - they could not be as effective as active seafarers sailing in their own ship, even discounting the impact of age and infirmity.

5.9 The proposed changes to arrangements for seafarers' income tax and national insurance contributions would mean an average annual loss of tax revenue to Government of £6,000 for each officer and £2,700 for each rating. But the pay-off is more new jobs for UK nationals spending their earnings in the UK economy (and paying VAT and Excise Duties).

5.10 These measures would go far to secure the supply of trained seafarers to fill the 10,000 or so jobs in maritime-related industries where direct shipping experience is needed. The Joint Working Party estimated that 1,000 qualified recruits are needed each year to fill these posts. They would also be of considerable defence significance.

GCBS
3.12.90

General Council of British Shipping

30-32 St Mary Axe London EC3A 8ET Telephone 071-283 2922 and 071-626 8131

Telex 884008 and 884768 SMA-G Facsimile 071-626 8135 (Group 3)

IME MINISTER

full
ORIGINAL on Elson Pw.
Budget A20SHIPPING AND THE BUDGET

You are aware of the lobbying from Lord Sterling on behalf of the General Council of British Shipping (GCBS) for tax concessions in the Budget. Attached is a thorough note from the Policy Unit setting out the case; the arguments for and against; and proposing a way forward.

It may be helpful to add two points.

- i) My understanding is that the Chancellor is not minded to give any tax concessions (neither special capital allowances, nor income tax/NIC exemptions for UK seafarers) in this year's Budget. It is accepted this will lead to more "flagging out" of UK ships. Treasury believe this will happen in any case.

When pressed strongly, it appeared that Treasury might have a fallback position. This would involve no concessions on capital allowances but a scheme for reducing seafarers' income tax liability. To the extent that enabled UK ship owners to keep down UK wages, it would provide indirect incentives to maintain the UK merchant fleet.

- ii) Jonathan Hill (Policy Unit) commends a thorough examination by the MOD of the strategic case. I understand from Charles that several such exercises have been undertaken in the past, beginning in 1984. Whatever the strategic case, MOD are very hard pressed: they will not be able to find money within their PES provision for any kind of support exercise for the UK merchant fleet.

You may want to raise this with the Chancellor at next week's bilateral. It is difficult to know how serious the fallback option envisaged by Treasury might be.

BHP

Barry Potter22 February 1991

c: shipping (MJ)

CONFIDENTIAL

4 BP
2 files
A
[Signature]



MINISTRY OF DEFENCE
WHITEHALL LONDON SW1A 2HB
Telephone 071-21 82111/3

SECRETARY OF STATE

Price Minister
To note. I defect no signs of Treasury
concessions. AT 24/2
25th February 1991

MO 10/13D



Norman

SHIPPING AND THE BUDGET

Malcolm Rifkind wrote to you on 9th January and 8th February *at Prop.* supporting the GCBS case for measures to bring the fiscal burden of the shipping industry more into line with that borne by its competitors. Lord Sterling's presentation of the GCBS budget submission to me has inevitably been postponed, but I am sufficiently familiar with this issue to be able to write in support of Malcolm's argument.

The defence component of the argument for a thriving British shipping industry is not the only one, but it is important. In certain scenarios there must be access to merchant shipping. Sometimes, not so far in the current Gulf conflict, the need could only be met by British shipping. I am acutely aware that the decline in the British flagged fleet over the past decade has caused our planning margins to become uncomfortably tight.

It is not for me to comment on particular fiscal measures, particularly as I have not yet heard the GCBS case at first hand. However, there can be no argument but that the defence interest is

The Rt Hon Norman Lamont MP
Chancellor of the Exchequer



CONFIDENTIAL

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SECRETARY OF STATE

best met by a thriving British flagged merchant fleet and that much more comfortable planning margins than we current enjoy are desirable. Malcolm's conclusion have my strong support.

I am copying this letter to the Prime Minister and Malcolm Rifkind, and to Sir Robin Butler.

Tom King





NAT IND. Shipbuilding
Policy Pt 6.

PRIME MINISTER

Changes Papers → back to 84/85.
Grateful for any views on the
MOD angle. Army Unit seem to be
looking for a way out of saying
a plain 'No'.

19 February 1991

BHP 19/2

You have asked the Chancellor to look again at the case being made by Lord Sterling and the General Council of British Shipping (GCBS) for special fiscal measures for the UK shipping industry.

Although this issue is not due to be discussed at your bilateral with Mr Lamont on Wednesday, it may be raised.

The GCBS case

The UK shipping industry is clearly at a considerable competitive disadvantage given the more favourable tax regimes under which many of its competitors in Europe and elsewhere operate. There are therefore strong financial incentives for UK shipping companies to "flag out", and the evidence appears to be that they are doing so in increasing numbers. The UK registered merchant fleet is growing older, as are the officers who serve in it. Employment of UK seafarers is falling steadily.

It is the contention of the GCBS that unless they are put on a more equal footing with overseas competitors, this decline will accelerate, and the UK merchant fleet will to all intents and purposes cease to exist.

Clearly the ideal solution would be for the EC to take action to eliminate the subsidies paid by other countries. Unfortunately, I cannot find anyone who considers that likely in the short or medium term. The issue is, therefore, whether or not there is a case for giving the UK shipping industry similar assistance.

What the GCBS is asking for

There is a strong sense of deja vu - the GCBS's submission to the Chancellor is largely unchanged from the ones made every year since 1984. They want:

- (i) a 100% capital allowance in order to stimulate investment in new ships;
- (ii) exemption from tax and employers' NI contributions for crews at sea. (They estimate that this would reduce the industry's wage bill for British seafarers by some 25%).

They propose that the package should initially run for 5 years.

The GCBS accept that such a package would mean that the UK shipping industry would have one of the most favourable tax regimes anywhere in the world under which to operate.

Costs

This year, the GCBS are being quite coy about putting a price-tag on the package they are seeking.

But in last year's Budget submission, they estimated - on the assumption that 40 new ships might be built - that the 100% capital allowance might cost an average of £150m per annum over the five year period. (£260m in Year 1, reducing to £75m in Year 5).

They put the cost of the tax exemptions at £60m per annum. So, the total cost over the five year period could be in excess of £1bn, some £320m of it in Year 1.

The Arguments for Helping the Shipping Industry

The GCBS, strongly backed by Mr Rifkind, believe that there are both economic and strategic reasons why we should give the shipping industry the support for which they are asking:

- it would benefit our balance of trade;
- it would help sustain marine-related activities such as finance and insurance;
- it would help maintain the predominant position of London as a maritime centre;
- it is vital to our strategic defence needs that we have enough UK merchant ships on which to call in time of war, and enough trained British seafarers to serve in them.

In addition, they argue that Britain is an island nation and that for historical and geographical reasons we must continue to maintain a viable merchant fleet.

The Arguments Against

The GCBS are asking for a considerable sum. Were the Treasury to introduce the fiscal measures the GCBS seek, it would undoubtedly send the wrong signal to other industries. It would also set a dangerous precedent to breach the principle established in the 1984 Budget that no capital allowance should exceed 25%.

The following arguments are also deployed:

- we do not need UK registered ships in which to carry

our trade. It makes more sense to charter ships at the cheapest possible rate on the open market. If other countries want to weaken their economy overall by subsidizing a part of it, that is a matter for them;

- 100% capital allowance would subsidize investment that would have taken place anyway;
- it could start a new round of increasing government aid across Europe as industries in other countries lobby to maintain their advantage;
- the MOD has had no difficulty in chartering ships for the Gulf. (Indeed, of the 130+ merchant ships we have sent to the area, only seven or eight are UK-registered.) The merchant fleet is still big enough to conduct a Falklands-type exercise.

Where the argument stands

Mr Rifkind has now twice written to the Chancellor in support of the GCBS case. He is due to meet Mr Lamont to discuss it further later this week. Mr King has not yet written.

In conversation, Mr Rifkind accepts that the economic arguments are finely balanced, but says that he is convinced by the merits of the strategic case. MOD officials, interestingly, argue that it should be decided on an analysis of the economic issues and not on the defence implications - although they do make it clear that they would be concerned if the merchant fleet were to grow smaller.

The politics of it

Some opinion poll research has been conducted among a sample of

100 MPs.

Predictably it shows that helping the shipping industry would be more popular with Labour MPs than it would with Conservatives.

86 per cent of Labour MPs supported the idea of introducing tax reliefs to encourage more British seafarers, but only 51 per cent of Conservatives. 89 per cent of Labour MPs, and 63 per cent of Conservative MPs, were in favour of fiscal allowances to stimulate greater investment in new merchant ships.

Options

There are a number of options:

- (i) turn the GCBS down - this is likely to accelerate flagging out and further shrinkage of the merchant fleet. Lord Sterling left me in no doubt that P&O, which accounts for a third of the merchant fleet, will flag out if the GCBS do not get what they are asking for;
- (ii) give the GCBS everything they want - this would be very costly, and would send the wrong signals about the Government's industrial and economic policy.
- (iii) give the GCBS less than the whole package - Lord Sterling claims that it is all or nothing, and that both parts of the package are mutually interdependent. I am sure they would, however, settle for less - maybe 50% capital allowances. While reducing costs, this would not however deal with the fundamental problem that we would be undermining the policy established in 1984. The chances are that the GCBS would just come back next year.

(iv) focus on the defence angle, and get the MOD to pay -
this would:

- (a) flush out just how serious the defence arguments are. (At present the MOD have an interest in playing them up because they receive a benefit which does not come out of their budget.)
- (b) get round the capital allowance and tax relief problem, and remove any announcement from the Budget arena.

Recommendations

Neither the Treasury nor the DTp are convinced by the economic arguments alone. The capital allowance and tax reliefs route does not look very promising. It may not therefore be right to push Mr Lamont further.

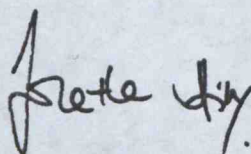
However, we should explore how serious is the threat posed to our defence needs by a further decline of the UK fleet. Malcolm Rifkind, in particular, finds the strategic case convincing. The defence card is the one being played most forcefully by the GCBS. And MOD do appear to have some concerns about a continued reduction in the size of the fleet.

It is important that we are able to assess the true weight of the defence implications. If the strategic arguments do not stand up, the whole case looks shaky.

Perhaps the best way of determining how vital the strategic considerations are, is to put the burden of proof on the MOD. The most effective way of doing that would be to make it clear to MOD that no additional money would be made available to the

shipping industry by means of tax relief or capital allowances. If the MOD are convinced that there are good strategic reasons to support the UK merchant fleet, they should devise a scheme for doing so, and either find the necessary resources from within their existing programmes, or bid for additional funds in the normal way.

If you agree with this approach, you may want to minute Mr King saying that you are not persuaded by the case made by the GCBS for fiscal measures. If he wishes to bring forward proposals as to how the MOD might want in future to support the merchant fleet, he should do so, within the PES context.

A handwritten signature in dark ink, appearing to read 'Jonathan Hill', written in a cursive style.

JONATHAN HILL

193.JH

SGR



THE DEPARTMENT OF TRANSPORT

*Prime Minister
To be aware
AT 8/2*



FROM THE SECRETARY OF STATE

2 MARSHAM STREET LONDON SW1P 3EB
TELEPHONE 071-276 3000

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

My Ref:

Your Ref:

*AT/. This dinner with Ed. Sterling
submission.
B/C with Ch.
@ bilateral*

8 FEB 1991

10.2

*Dear Norman,
at ship.*

I wrote to you on 9 January, expressing support for the request from the GCBS for a degree of fiscal assistance for British shipping in the forthcoming Budget. Since then there have been some further developments to which I might draw your attention.

In January, I touched upon the NATO study of demand for merchant shipping in crisis and war. We have been carrying out further analysis of this study and our assessment of the UK elements of it indicates that we would have to rely on our NATO allies for over 50 ships of the most critical categories, including product tankers, large Ro/Ros and large general cargo ships. And even this is on the optimistic assumption that all ships with UK parent ownership (whatever the flag) would be available, and that ships would be used to their maximum, even carrying cargoes for which they would not be considered suitable in peacetime. The scenario of the NATO study - a war between NATO and the Warsaw Pact - can now be questioned but the extent to which the UK would have to rely on its NATO partners in a NATO war, indicates the increasing difficulty we would have in undertaking out-of-area operations. In those situations we might not be able to count on our allies supporting us by making their shipping available. We are also seeing reports relating to the Gulf that even when the ships are available, foreign officers and crews are refusing to man them. At present we still have just enough vessels available to mount an operation on the scale of the Falklands but the choice of ship would, however, be much more limited than in 1982 and the disruption to the normal trading activities of the British merchant fleet would be considerable. This state of affairs can only get worse if the decline of the British merchant fleet continues.

Elsewhere in the world, Governments are continuing to respond to growing competition in shipping markets by supporting their national fleets. Since I wrote to you, just a month ago, I see

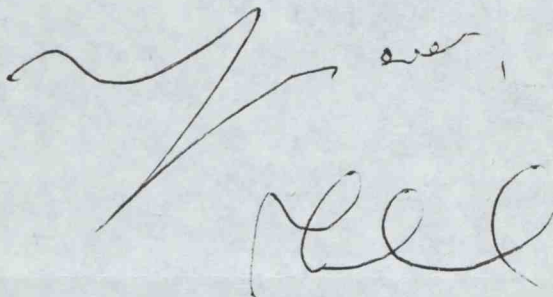
POLICY-IN-CONFIDENCE

that the Spanish Ministry of Transport, for example, has granted direct aid totalling some £58 million to four national shipping companies to encourage investment, technological innovation and improved productivity. Also, it has recently been reported that moves by the Greeks to cut tonnage tax on Greek-flagged vessels have already had beneficial effects in terms of attracting ships back to their register. More generally the creation of second registers, often linked to tax advantages, continues.

Our shipping industry is hanging on for a Budget in the hope that their submission will be acted upon. If their hope is not realised, I am afraid that the consequences will be damaging.

The fiscal measures proposed have been kept reasonably modest and are, in my judgement, the minimum required if the United Kingdom is not, for the first time in its history, to be without a significant merchant fleet.

/ As before, I am copying this letter to the Prime Minister, to Tom King, and to Sir Robin Butler.

A handwritten signature in dark ink, appearing to read 'M Rifkind', with a stylized flourish above the name.

MALCOLM RIFKIND

/ P.S. I enclose an editorial from the Daily Mail which shows the wider interest in this subject.

POLICY-IN-CONFIDENCE

Reviving shipping ⁶

AT this time of year, the Chancellor hears many pleas for special treatment. He will not hear a better case than that for the revival of the British merchant marine. Nor one that has more parliamentary backing, for 88 per cent of MPs want action to that end.

A joint government/industry working party has agreed that a large number of ships flying the red ensign and manned by British seafarers is essential for national defence. Even those who believe that the survival of any industry should depend purely on its competitiveness should remember that Adam Smith himself made an exception of shipping on the grounds that 'defence is preferable to opulence'.

The alternative, which the Americans have tried, of keeping a mothballed fleet in case of national emergencies, is more expensive and less effective because it is less quickly mobilised than one which is already up and running.

The shipping industry is campaigning for UK seamen to be exempt from tax and national insurance contributions and for a 100 per cent tax allowance on the building of new ships. The concessions could prove less costly than the Treasury might think.

For, if there is no exemption for British seamen, most of them will cease to be taxable anyway because they will move to employment on vessels flying foreign flags. The 100 per cent allowance on new boats would mean that our shippers would tend to pay less tax on their profits in the first year but more in succeeding years. In addition, since the world's merchant fleet is ageing, the present is a particularly favourable point in the replacement cycle at which to invest in new vessels.

In a nutshell, the British merchant navy deserves support because it is a vital national asset. If encouraged to expand now, it could prove a very profitable one as well.

Call for tax cuts to save merchant fleet ¹⁰

SHIPPING bosses want the Chancellor to lower taxes to save Britain's ailing Merchant Navy.

They say UK seamen should be made exempt from tax and National Insurance. They also want a 100 per cent tax allowance on the cost of building new vessels.

In a MORI poll commissioned by industry chiefs, 88 per cent of MPs said a British fleet was necessary for defence purposes.

A further 64 per cent said they would support the Chancellor over tax concessions. The poll also revealed that 85 per cent of MPs believe a Red Ensign fleet is important to trade figures.

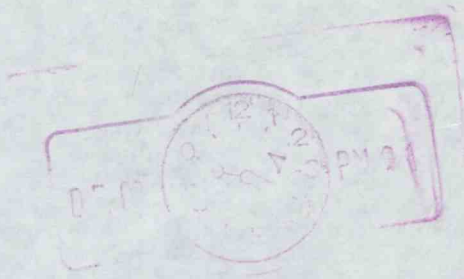
Since the end of World War II, the British-owned merchant fleet has shrunk from 1,500 vessels to 600. The number of British officers

By DAVID NORRIS
Industrial Correspondent

and ratings has dropped 150,000 to 20,000.

Some owners have registered their ships in other countries so they can employ cheaper crews or chartered foreign vessels because it is not viable to build new ones.

Comment — Page SIX



NAT IND : Shipbuilding
Pt 16

President :
The Rt. Hon. The Lord Sterling
of Plaistow, CBE.

General Council of British Shipping
30-32 St. Mary Axe
London EC3A 8ET
Telephone : 071-283 2922

6th February, 1991

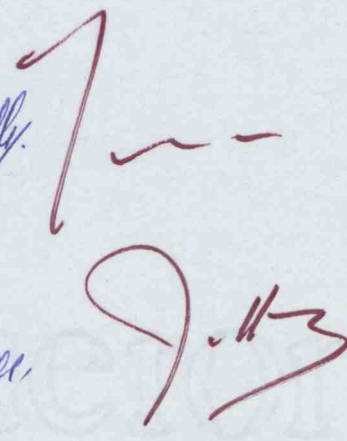
The Rt. Hon. John Major, MP.,
Prime Minister,
10, Downing Street,
London, SW1A 2AA.

8/2

Your Prime Minister,

I have today sent the attached letter and supporting documents to editors of national press, radio and television. I wanted you to have a personal copy at the same time.

Andrew/
I understand to. orw. But
has Ch. really considered this carefully.
It is a very emotive subject
particularly @ present.
B/U for next bilateral pluss.
/9.2



✓ Prime Minister
Like J. Sterling himself, this takes a long time to get
to be point. The two proposals - 100% depreciation
for ~~passive investment~~ = ships, and exemption from income tax
and employers' nict for ~~each~~ right a ~~separate~~ spends at sea -
are set out on pp 7-12. The Treasury remain unsympathetic.

AT
8/2

President :
The Rt. Hon. The Lord Sterling
of Plaistow, CBE.

General Council of British Shipping
30-32 St. Mary Axe
London EC3A 8ET
Telephone : 071-283 2922

6th February 1991

We have now published the Shipping Industry's submission to the Chancellor; a copy with summary is enclosed.

However, the main purpose of this letter is to draw your attention to the results of an opinion poll of MPs undertaken by MORI.

The clear conclusions are that a heavy majority of MPs support the economic, defence and employment potential of a UK registered Merchant fleet. I have attached the MORI results.

Equally clear is that without the appropriate Treasury action, the present decline in the British flagged fleet will inevitably continue, in an accelerated form - it has reduced by 86% in the past 12 years as demonstrated in the joint Government/Industry Report which I sent you.

It is neither threatening nor theoretical to contend that, given the present uncompetitive fiscal conditions attaching to the industry, the end of the UK red ensign is, for all practical purposes, clearly in sight. That conclusion is drawn from the economic facts of life in the international shipping industry. It is inescapable.

There will, of course, continue to be a British owned shipping industry but it will not fly the UK red ensign nor will it recruit British seamen, nor will it be capable of meeting this country's defence requirements. I do not believe we should allow this to happen. Nor, obviously, do many Members of Parliament, of all parties.

In the light of the conclusions of the Joint Government/Industry Report I would find it difficult to believe that the Government could accept the certain demise of the UK red ensign. However, whilst they still consider their options I would hope you may have time to consider the facts and their conclusions and support our aims.

MORI

95 Southwark Street
London SE1 0HX
Tel : 071-928 5955
Fax: 071-955 0070/1

4 February 1991

The Lord Sterling of Plaistow
President of the General Council of British Shipping
30-32 St Mary Avenue
London EC3A 8ET

My Lord

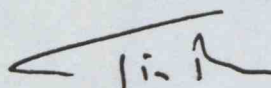
Attitudes of MPs Towards the British Merchant Fleet

The attitudes of MPs toward the British Merchant Fleet are largely favourable and supportive. The key findings are:

- 85% consider it to be important to the Balance of Payments to have such a fleet sailing under the Red Ensign (54% consider this to be very important).
- 88% of MPs believe that it is important for Britain's defence to have a sizeable British Merchant Fleet sailing under the Red Ensign (50% consider this to be very important).
- 64% of MPs would support the Chancellor if he provided tax and National Insurance concessions to encourage the British Merchant Fleet to employ and train more young people for careers at sea. Nineteen percent would oppose such a move.
- In addition, three quarters (74%) would support the Chancellor providing some allowances to encourage greater investment in new merchant ships. One in five (21%) would be opposed.

The results are based on a telephone survey of 100 MPs carried out by MORI between 1-3 February 1991. The sample excludes Cabinet Ministers and MPs from Northern Ireland, and was structured to be representative by party.

Yours faithfully



Tim Burns
Deputy Managing Director



Press Release

Contact: Andrew McNeil
Office Tel: 071 283 2922
Home Tel: 071 435 7349

5 February 1991

FOR IMMEDIATE RELEASE

MPs VOTE RED ENSIGN MUST STAY

88% SEE IMPORTANT DEFENCE ROLE FOR MERCHANT NAVY STRONG ALL PARTY SUPPORT AS BRITISH SHIPPING FISCAL SUBMISSION IS PUBLISHED

A MORI poll of MPs shows that 88% consider it important to the UK's defence and 85% to its Balance of Payments that British ships should fly the Red Ensign; and 74% would support the Chancellor if he provided allowances to encourage greater investment in new merchant ships.

Such encouragement for investment - a writing down allowance of 100% - is one of the main proposals in British Shipping's submission on fiscal issues sent to the Chancellor for consideration in the Budget.

The Chancellor would be supported by 64% of MPs if he provided tax and National Insurance concessions to encourage British shipping to employ and train more young people for careers at sea. British Shipping's submission urges that the burden of seafarers' income tax and NI contributions should be removed from shipping companies' costs.

The strong cross-party support was welcomed by the British Shipping President, Lord Sterling, who said that the poll - commissioned ahead of the Submission's publication - showed that most MPs shared the view of the Joint industry/Government Report published in September, that British shipping was a vital national asset.

General Council of British Shipping

30-32 St Mary Axe London EC3A 8ET Telephone 071-283 2922 and 071-626 8131

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Lord Sterling added:

" The fiscal measures we propose will act as a catalyst for investment and growth in the shipping industry. To ignore this would accelerate the demise of the British flagged merchant fleet. With the proposed incentives we could reasonably expect the balance of payments contribution from shipping - already large at £5 billion - to reach £10 billion by the end of the decade, and at the same time to continue to provide the crucial fourth arm of defence of modern merchant ships and trained British seafarers."

British Shipping's closely argued submission to the Chancellor demonstrates that the impact of a 100% ship allowance on tax revenues would be slight, since the costs of initial relief would be balanced by greater corporation tax in subsequent years.

The submission also shows that changes to the arrangements for seafarers' income tax and National insurance contributions, while having revenue implications for the Government, would at the same time create more jobs for UK nationals spending their earnings in the UK. The Joint Working Party estimated that 1000 qualified recruits are needed each year to fill posts in the maritime-related industries.

ends

NOTES TO EDITORS

The General Council of British Shipping (GCBS) is the trade association representing around 145 British companies who between them operate or own over 800 deep sea and short sea ships and offshore support vessels of some 21.5 deadweight tonnes. In addition, there are about 100 standby safety vessels, 180 coastal vessels and 200 tugs, represented by other bodies associated with GCBS.

British Shipping contributes £5 billion a year to the balance of payments and is the country's third largest earner of invisible exports, after tourism and insurance and ahead of civil aviation.

British Shipping - Challenges and Opportunities was the Report of a Joint Working Party chaired by the Secretary of State for Transport and the President of the General Council of British Shipping, HMSO September 1990.

A telephone survey of 100 MPs was carried out by MORI between 1 and 3 February 1991. The sample excluded Cabinet members and MPs from Northern Ireland and was structured to be representative by party. [MORI contact - Tim Burns 071 928 5955].

PRIME MINISTER

SHIPPING INDUSTRY

*Why not say: Done AT 28/11
(a) NC/HR briefed me
(b) That prepared speech
(c) Concluded to defer in view of Gulf pressures. 26.1*

Before the Guidhall dinner, Lord Sterling and a group from the General Council of British Shipping were due to come to No.10 to make a presentation to you on the state of the shipping industry. This got cancelled in the midst of the events of the last week.

Lord Sterling has been pressing me to reinstate this presentation. In my view this would be a waste of your time. He has made his presentation both to the Secretary of State for Transport and to the Chancellor. In preparing yourself for the dinner you familiarised yourself with the issues. These are set out succinctly in Mr Rifkind's letter to the Chancellor - copy attached. I doubt if you would learn anything in 45 minutes that you could not find out in five minutes by reading this letter. Mr Rifkind also feels this is not a good use of your time.

Lord Sterling would of course be mightily offended and I would get 'phone calls three times a day for a week. But I see no reason why you should be pressurised by him.

Agree I tell him you do not think the presentation is now necessary?

AT

Andrew Turnbull

24 January 1991

c: sterling (MJ)

CCFO



THE DEPARTMENT OF TRANSPORT



FROM THE SECRETARY OF STATE

2 MARSHAM STREET LONDON SW1P 3EB
TELEPHONE 01-376 3000 071-276 3000

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

My Ref:

Your Ref:

*Prize Money
I will find out what the
Treasury think about this.
But I think it is, you will
not be able to make any
promises on Thursday*

- 9 JAN 1991

*No - but I would like to
know their view. It will
be relevant I suspect. f.12.1*

Dear Norman

SHIPPING AND THE BUDGET

We have now both seen Lord Sterling's presentation of the GCBS budget submission. I have also seen the paper which NUMAST has submitted to you.

*with request
if required*

Coming new to shipping, I have been very encouraged by the positive framework for action agreed between the Government and the industry in the recent Joint Working Party report on British Shipping. But there are wider factors affecting the industry, which the report identified but could not properly address. The situation, illustrated in the annex to this letter, is grim.

I might view the rate and extent of contraction of British shipping with more equanimity if it were a dying industry whose inefficiencies made it uncompetitive in the modern world. But it is full of entrepreneurial flair, enthusiasm and the competitive spirit, trying to survive in a world where every competing developed country subsidises in one way or another its shipping activities. It is asking too much of flair and spirit to overcome such distortions.

Quite apart from the strategic and defence issues, I do not believe that simply relying on cheap subsidised shipping services provided by flag of convenience and other subsidised fleets is politically acceptable. We are an island seafaring nation, relying almost entirely on shipping for the international movement of goods and supplies. I do not think that the British people would support or understand Government indifference to the existence of a British merchant navy.

Over the last decade the industry has survived basically by moving many of its ships to other registers. But complete transfer is no basis for a long-term shipping policy. It would

involve abrogating responsibility for safety standards, leave the fleet dependent on other countries' continued willingness to tolerate foreign ownership and control, and over time reduce our maritime abilities to the areas of finance and insurance.

I imagine that the defence case for providing assistance to the shipping industry is something on which Tom King will want to comment. For my part, I have a responsibility for ensuring that adequate shipping is available to support military operations and for civil resupply in crisis and war. This responsibility applies just as much to seafarers as it does to ships.

A recent NATO study suggests that by and large adequate shipping would be available to the alliance in crisis and war, though the scenario envisaged has become less likely with the demise of the Warsaw Pact. The position on shipping resources for any out of area action, in particular one where we stood alone with little or no support from our allies, could be more difficult. Any further rundown in the British fleet would leave us even more dependent on foreign flag ships. It is impossible to say how easily they could be chartered or at what cost; it would depend on the circumstances of the day.

We are discussing with the Ministry of Defence a relaxation of the restrictions on the nationality of the three most senior officers on British ships, to give the shipping industry more flexibility in coping with the difficulty of finding British officers and to meet EC requirements. But at the same time we need to encourage greater use of British officers and men so that they will be available to us in a crisis. There would be little advantage in being able to charter foreign ships in a crisis if foreign crews, perhaps instructed by their governments, refused to sail them. We have made some improvement in the supply of British officers thanks to the training assistance introduced two years ago, but we have done nothing about the supply of other British crew. And the current world shortage of officers seems likely to extend during the decade to ratings.

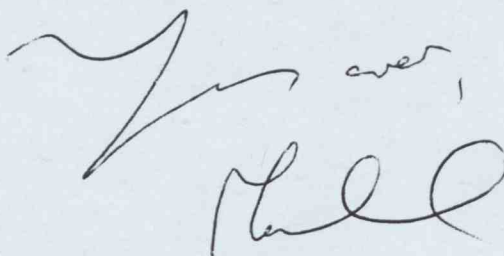
I shall vigorously implement the recommendations of the recent Joint Working Party and take whatever other action I can to help the industry to thrive. We may, for instance, now be close to opening up part of the European closed cabotage market, a development which will give modest new opportunities to some of our short-sea owners. But it will inevitably be by this year's Budget that the Government's attitude to the industry will be judged. It is no simple rerun of the pressure there has been every year since 1984. UK shipowners are waiting before taking important decisions about replacing their ageing tonnage. If nothing is done to reduce the imbalance in the fiscal burden relative to our industry's main competitors, the Government will be perceived as largely indifferent to the UK fleet. No matter what progress is made on the various recommendations of the Working Party, we would have to expect a rapid and substantial further reduction in the UK fleet. It must be better to try to prevent that than to try to recover afterwards.

The particular measures proposed by the GCBS (free depreciation of investment in ships, and exemption from tax and NI for crews

at sea) are ones which they clearly believe will help the industry to compete on a more equal footing with the fleets of other countries. They have my strong support. We are so far behind the others in terms of the help we give that the measures are extremely unlikely to lead to any increases in subsidies by other states.

If you want further work on how the measures could be framed so as to minimise any danger of repercussions, my officials will, of course, be prepared to give any help they can.

I am sending copies of this letter to the Prime Minister, to Tom King, and to Sir Robin Butler.

A handwritten signature in black ink, appearing to read "Yours ever, Malcolm Rifkind". The signature is written in a cursive style with a large initial "M" and "R".

MALCOLM RIFKIND

ANNEX

BRITISH FLEET: 1980 - 1990

Date	Number Of Ships	Total Tonnage	Tonnage Split By Registers		
			UK	CD	DT
1980	1964	46	43	-	3
1981	1802	42	41	-	1
1982	1678	36	35	0	1
1983	1568	31	29	0	2
1984	1463	25	23	0	2
1985	1411	24	21	0	3
1986	1374	23	16	0	7
1987	1223	20	7	4	9
1988	1152	23	6	4	13
1989	968	22	5	4	13
1990	862	19	4	3	12

Notes:

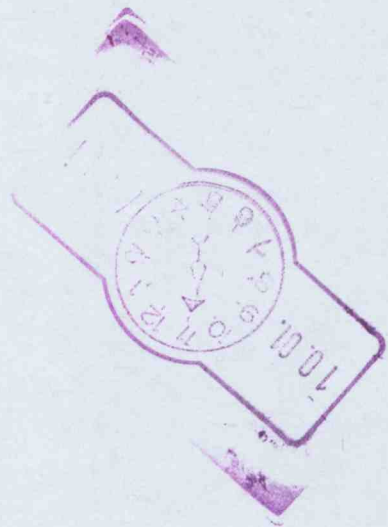
1. Figures are based on trading vessels over 100 gross registered tonnes. Tonnage figures are in millions of deadweight tonnes.

2. CD = Crown Dependencies (Isle of Man, Channel Islands)
DT = Dependent Territories excluding Hong Kong (mainly Bermuda, Gibraltar and Cayman Islands).

3. Prior to 1982 separate figures for the Crown Dependencies are not available.

4. British Registered Vessels are not necessarily UK owned. For example in 1986 there were 924 UK owned vessels, and 805 UK owned vessels in 1989.

5. During the period in question the size of the world fleet remained virtually unchanged - in 1980 398 million gross registered tonnes; in 1990 385 million gross registered tonnes.



Ru

Norman Lamont's first budget is expected to contain measures specifically designed to aid the British merchant shipping industry. Surely not, you may say, after 11 years of Thatcherism in which industrial subsidy was systematically dismantled as an instrument of policy. Yet this prediction can be made with some confidence, though neither the chancellor nor any of his officials, advisers or confidants has given the least hint that it will be so; not even when he met shipping representatives earlier this month.

The expectation is based on observing at close quarters the lobby being constructed in its favour under the audacious captaincy of Sir Jeffrey Sterling of P&O. The sight of this particular flotilla, under a full head of steam, bearing down on the poor, defenceless chancellor is so awesome that even he may be blown out of the water.

If you remain sceptical, just imagine you were in Sir Jeffrey's position as president of the General Council of British Shipping, had his daring, and were determined to get your way. How best could you launch your campaign? Clearly you would want to enlist the aid of Britain's most eminent seafarer. Perhaps, you might think, you could somehow link it with Britain's best-loved ship. You would then want to assemble a selection of the great and the good, including a high proportion of those you would expect to be sympathetic, so that any sceptics felt isolated. You would, of course, furnish them with a plausible argument or two but, above all, you would invest the whole operation with a romantic aura of sea and storm and salt-filled air. Add good food and wine undreamt of in the average mess, and glory seems certain, be your case good, bad or indifferent.

The result of such thinking turned out, much hard work later, to be a lunch. Not any old lunch, but a lunch hosted by the Duke of Edinburgh (top seafarer, a Mountbatten and who could resist meeting him?) That dealt with best-loved ship: the Duke made available the Royal Yacht Britannia, just a bracing launch ride from Tower Hill pier to get the wind in the guests' lungs and the spirit of Conrad in their minds.

Who came? A distinguished and nautical company, led by Lord Callaghan (ex-petty officer RN and former prime minister) and Lord Whitelaw (fewer ships, it is true, in Cumbria, but a military man with a strong and noble attachment to vaguely-defined national interest). They were joined by the present transport secretary, his predecessor and the shipping minister, and by two of the most powerful Tory backbenchers, one of whom had seven years in the shipping industry. The First Sea Lord and the chairman of the Commons defence

Andrew/.

committee were there, together with journalists and other mortals. There was superb food (lobster and pheasant) and superb wine.

The event was off the record, and to breach that confidentiality would lead one to end up at Traitors' Gate, opposite where the yacht was moored. But the journalists were invited doubtless to spread the gist of what was said, which was the industry's strategic national importance. Ninety-five per cent of goods go by sea, say the shipping representatives (though whether this impressive figure is by tonne, tonne-mile, or value, let alone why it should matter whether it be carried by British ships or foreign ones was not vouchsafed). They complain that their foreign competitors are subsidised (which, as any student of the economic literature knows, makes not the slightest difference to the case against subsidising our own industry. If foreigners are prepared to sell us services cheaper, financing the difference from their taxpayers' pockets, bully for Britain).

The representatives of the navy, and, without in any way divulging what position the Duke may or may not have taken, are worried about defence. They argue that if there is a war, they need a merchant navy to take the troops to it. The Indian government withdrew its sailors from the Canberra when she sailed to the Falklands, and if our ships are manned by other than true-Brit tars, who can say if they will be able to get to war?

The ease with which ships can be hired in the modern world, whether to transport men or goods, seems not to have occurred to these plain sailors; nor whether it makes sense to support an entire merchant fleet just in case, every decade or two, a ship might come in handy.

The representatives of the Tory party are, of course, aware that they are now supposed to oppose subsidy. They raise the obvious objections, but then hum and haw and wonder if aid to this oh-so-special industry could not be ring-fenced, so it and only it would be entitled to the government's beneficence.

As it happened, I had dined a couple of weeks previously with an entrepreneur who had made a fortune in shipping, selling up shortly before the current recession began. He is not planning to buy any more ships just now, but is quietly preparing himself. When the recession looks like ending, and the time is ripe, he will pile back into the industry with every expectation of making money. A bit of Treasury dosh would make him more enthusiastic, if Mr Lamont does indeed oblige. But the extra incentive that may result from Sir Jeffrey's supreme effort will be icing on his personal cake. Mr Lamont should save his resources for those who would be glad if they could afford bread.

*Pl. pass to Chancellor
to me if he'd
mean that.*

*John H.
26.12*

David Lipsey

Save our ships
—at a price

TIMES - WEDNESDAY 19th DECEMBER

me h

PRIME MINISTER

BRITISH SHIPPING

Mrs. Thatcher agreed to address the Annual Dinner of the General Council of British Shipping on 17 January. It is a high profile, white tie occasion at the Guildhall to which the great and good not only of the shipping world, but also the City, have been invited. The Prime Minister was initially reluctant to accept the engagement but did so in the end as a favour to Sir Jeffrey Sterling who is the President of the GCBS this year.

You will need to consider whether this is an engagement you should treat as being accepted in the name of the Prime Minister, the Government or Mrs. Thatcher personally. Given the eminence of the guest list - copy attached - I regretfully conclude that it is for you and that you could not subcontract it to the Secretary of State for Transport.

The occasion will be a tricky one as the industry has been in steep decline for some years. However it will be a timely one as Sir Jeffrey Sterling has been making a determined effort to reverse that decline. A Joint Working Party was set up, chaired by the Secretary of State for Transport and Sir Jeffrey, to assess the state of British shipping and to identify measures which could improve matters. You might like to glance at the report. Chapter One provides a summary. Chapter Two documents the problem and Chapter Three looks at possible solutions. It was agreed beforehand that fiscal measures were outside the remit of the study. The GCBS will be making separate budget representations to the Chancellor, e.g. for faster depreciation measures, but the Chancellor's response will not be known by January.

Mr Parkinson's minute attached sets out the progress which has been made since the report was published in September. It also suggests that you might have a meeting with Sir Jeffrey in early

January to brief yourself on the industry and the line to be taken at the dinner.

I have commissioned some material for the speech. It will not be straightforward as you will want to give an encouraging and upbeat message which will not be easy given the state of the industry. They will be looking to you to pull various rabbits out of the hat in the form of Government help and it will be difficult to meet their expectations. Nevertheless, there will be some good points to put across, e.g. the market in which they are operating, and the movement of goods in and out of Britain, is a growing one so the problem is one of market sharing rather than overall decline of the market; there is a new urgency on the part of the Government to find shared solutions; the abolition of the Dock Labour Scheme has transformed the ports through which shipping operates.

I hope to be able to put together a draft between Christmas and the New Year.

Agree to fulfil the engagement?

Agree to briefing in January?

AT

ANDREW TURNBULL

30 November 1990

c\pps\shipping.kw



DEPARTMENT OF TRANSPORT
2 MARSHAM STREET LONDON SW1P 3EB

My ref:

Your ref:

The Rt Hon Sir Geoffrey Howe QC MP
Secretary of State for Foreign
and Commonwealth Affairs
Foreign and Commonwealth Office
Downing Street
LONDON
SW1A 2AL

CDP
17B

16 March 1988

Dear Sir,

SHIPPING CABOTAGE

attached

OD(E) agreed on 25 February that I should take an enabling power in the Merchant Shipping Bill to introduce a test of establishment for the provision of cabotage services in UK coastal waters. David Mitchell duly announced at Committee Stage on 3 March that we would bring forward such an amendment at Report and Third Reading. This was warmly welcomed on all sides of the House.

I have now received a final draft of the new clauses from Counsel; the Home Office and Lord Chancellor's Department have been consulted and agree their content. Counsel has found a satisfactory formulation for handling the criteria of establishment in the Clause. I have consulted the Attorney General and he is content with the new clauses as drafted although he wishes to be consulted on any Order implementing the power. Accordingly I now propose to table the new Clauses tomorrow or Friday.

I am copying this letter to members of OD(E).

[Handwritten signature]

PAUL CHANNON

Paul



DEPARTMENT OF TRANSPORT
2 MARSHAM STREET LONDON SW1P 3EB

My ref:

Your ref:

cc/c

The Rt Hon Sir Geoffrey Howe QC MP
Secretary of State for Foreign
and Commonwealth Affairs
Foreign and Commonwealth Office
Downing Street
LONDON
SW1A 2AL

CR

Dean Jeffrey

- 5 FEB 1988

SHIPPING CABOTAGE

Thank you for your letter of 27 ^{Jan} January. I am grateful that you and other colleagues agree that we must keep up the pressure on other Member States to open up their markets. This frustration is felt keenly in Parliament too; during the Merchant Shipping Bill's Second Reading many speakers argued forcefully for some kind of action. However, I have noted your reservations and those of David Young about my proposals for an enabling power and we shall of course be discussing these points at OD(E) on 25 February.

I accept that we may ruffle some feathers in the Community and that if we had to implement our scheme we would face a risk of legal challenge in the European Court. But I hope to be able to persuade you and David Young that any risk in this case would be well worth taking. When viewed alongside the restrictive laws and practices of five of the Member States and the "free-for-all" which exists in the UK cabotage market, I would expect our Community colleagues to recognise the very restrained nature of the enabling power which I seek. So I hope you will be able to agree in due course.

I should like to take this opportunity of disposing now of the particular concerns which Douglas Hurd has expressed in his letter of 27 January. First, I can give the assurance which he seeks: if no serious prospect emerges soon of securing a political solution in the Council, I would propose to bring into effect the enabling power which I now seek; though the timing would of course be a matter for consultation with you. If on the other hand we were to succeed in getting an early regulation establishing the freedom to provide cabotage services, the entire legal background would be changed and I am sure nobody would want

to dispute that a redundant power could be the subject of a repeal at a convenient opportunity. Second, Douglas Hurd emphasises the need to provide a workable definition of 'establishment', so as to provide operators and the Courts with some clear guidelines. The Attorney General has made a similar point. I agree; your officials have pointed to the Financial Services Act 1986 (Section 31(2)) and we would propose to instruct Counsel to model the definition on that.

But I am concerned that we do not run out of time. It will be essential to have a clear policy decision on my proposal from the meeting on 25 February in order that the necessary provisions can be drafted and tabled for introduction at the latest at Report Stage of the Merchant Shipping Bill which we must expect to take place around the middle of March.

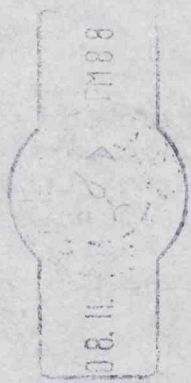
As agreed last week, I shall be setting out shortly, for consideration at the meeting on 25 February, my thoughts on transport aspects of the Single Market, including, of course, shipping cabotage.

I am copying this letter to colleagues as before.


PAUL CHANNON 

TRADE: SHIPPING

Cabotage JAN 88





cc k

Treasury Chambers, Parliament Street, SW1P 3AG

The Rt Hon Paul Channon MP
 Secretary of State for Transport
 Department of Transport
 2 Marsham Street
 London
 SW1P 3EB

CDP 2/1

28 January 1988

Dear Paul,

SHIPPING CABOTAGE

Thank you for copying to me your letter to Geoffrey Howe. I realise that the debate on how best to deal with the problem of cabotage is complex and any solution far from obvious. Your proposal to take an enabling power to require companies serving UK coastal trades to have a permanent presence here has both advantages and disadvantages and it is not entirely clear that the benefits you envisage would be forthcoming. I should like to register my concern that the move may be counter-productive and would run against the general trend to liberalise markets, rather than restrict them. That said I do take your point that the enabling power is intended as a negotiating device and could prove effective. I am therefore prepared to accept your proposal.

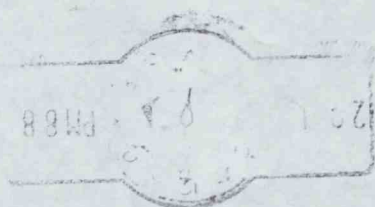
FILE WITH CDP

I am copying this letter to the Prime Minister, Geoffrey Howe, to other members of OD(E), to Douglas Hurd, Nicholas Ridley and Cecil Parkinson and to Sir Robin Butler.

Yours Ever,
John
 JOHN MAJOR

TRADES: Shipping Cabotage Jan 88

38405





SECRETARY OF STATE FOR ENERGY

THAMES HOUSE SOUTH
MILLBANK LONDON SW1P 4QJ

01 211 6402

The Rt Hon Paul Channon MP
Secretary of State
Department of Transport
2 Marsham Street
LONDON
SW1P 3EB

CDD
29/1

28th January 1988

Dear Paul,

SHIPPING CABOTAGE

Thank you for copying to me your letter of 21 January to Geoffrey Howe. I am content with your proposal to include an enabling power in the Merchant Shipping Bill to require companies wishing to serve our coastal or offshore supply trades to have a permanent presence in the UK. I note that the purpose of the measure is to provide leverage in negotiations with EC member countries who reserve their own coastal trade for their own vessels whilst exploiting our open market.

We do have, however, one concern. The UK has recently won some important contracts in other industrial sectors for the Norwegian Gyda field and we would not wish it to appear that we were tightening up the supply boat market with new legislation aimed at Norway. You will appreciate that Norway is sensitive on the subject following the success of my Department's special initiative to win such business for the UK. If the Norwegians express concern about the enabling power, we believe they should be told unequivocally that the measure is aimed at securing reciprocal treatment for UK vessels within the EEC.

I am copying this letter to the recipients of yours.

Yours Sincerely,
Cecil

CECIL PARKINSON

TRADE: Shipping Cabotage Jan 88

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1988



CONFIDENTIAL

FCS/88/016

SECRETARY OF STATE FOR TRANSPORT

Shipping Cabotage

1. Thank you for your letter of ¹²¹ 21 January about the need to secure free access for UK shipping to coastal trade in France, Spain, Portugal, Greece and Italy. This has long been a UK priority and we must keep up the pressure on other member states to open up their markets.

2. Subject to the advice of the Law Officers, the right course would I believe be to pursue the 1986 idea of persuading the Commission to mount - or ourselves mounting - a case in the ECJ. This would apply effective pressure on other member states (rather as the Commission threat of legal action pushed reluctant member states into agreeing to air transport liberalisation).

3. The course you propose, on the other hand, has the following defects:

- (i) Likely ineffectiveness. The five EC countries which restrict our access to their cabotage together account for only about 4% of the UK cabotage market. They are much more concerned to keep us out of their markets than to gain access to ours. The

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/action

cc/c

EC D (1)

*COO
1/2.*

PS Mrs Chalker

Mr. Brimacombe

Mr. Slater

Mr. Beerman (MPS)

Legal Adv

Mr. Plowman (MPS)

J Holroyd, Cab. off.

Mr. Kerr

Plap.



CONFIDENTIAL

action you propose would exert no pressure on them: we should only be formalising the existing unsatisfactory situation.

- (ii) The risk of having to reverse engines. Despite what Counsel has said, my legal advice is that there is a very real risk of an early - and successful - challenge before the ECJ under Article 53 of the Treaty (which prohibits new restrictions on the right of establishment).
- (iii) The knock on effects. I see the short term advantages for the British fleet of reducing competition in our cabotage trade but it would be a very short-lived advantage if we were taken to the ECJ and lost; and even more short-lived if, as is likely, our action led to further protectionism by non-EC member states. In that respect what you have in mind runs counter to our clear policy objectives.
- (iv) Losing our allies. We would penalise the Dutch and Germans whose coastal trade is already open to our shipping. Far from encouraging them to support us, I fear our action would lead them to take similar measures, support any Commission legal action against us.



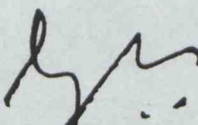
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4. I note your fear that if we were to go to the ECJ the best we could hope for would be a ruling allowing traders to operate if they set up a subsidiary or sole agency in the country concerned. That cannot be a foregone conclusion. A successful ECJ case would at least gain us access to the coastal trade of other member states, which a unilateral retaliatory measure would not.

5. I also note your concern that a Court case could have adverse implications for liberalisation in the aviation field. I am not persuaded that these fears are justified. The Court is normally inclined to stick to the issue immediately before it. Moreover the Commission would have no interest in trying to secure a restrictive outcome - quite the reverse.

6. I therefore hope you will not refer in the House to the idea of taking new enabling powers, but will instead say that the Government are continuing to press for an early conclusion to negotiations on EC shipping cabotage and are considering bringing a case before the ECJ. It clearly would be wrong to go further until we have had the views of the Law Officers.

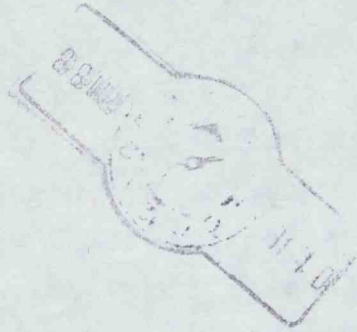
7. I am sending copies of this letter to the Prime Minister, to members of OD(E) and 'L' Committees, to Douglas Hurd, Nicholas Ridley, Cecil Parkinson and Tom King, and to Sir Robin Butler.


(GEOFFREY HOWE)

Foreign & Commonwealth Office
27 January 1988

CONFIDENTIAL

TRADE: Shipping Cabotage, Jan 88





QUEEN ANNE'S GATE LONDON SW1H 9AT

27 January 1988

Dear Paul,

SHIPPING CABOTAGE

You copied to me your letter of 21 January to Geoffrey Howe about the provisions you wished to add to the Merchant Shipping Bill in order to regulate cabotage.

I have no comment on the central question of whether cabotage should be regulated, but there are two important points I should make about the proposals you have in mind. The first is that I would not wish to see new offences added to the criminal law unless there was a clear intention that they should be brought into effect. As I read your letter, you intend to put the legislation in place against the contingency that it will not be possible to solve the problem by negotiation. On the other hand you seem to imply that the existence of these offences, ready to be implemented, will strengthen our hand in negotiations with our recalcitrant EC partners. If the main objective of the legislation is to secure a negotiated settlement, after which the legislation could presumably be repealed without being brought into effect, I would be concerned. I would welcome some reassurance that this is not your intention.

My second point is directed more to the detail of the proposals which your officials have discussed with mine. I understand that the system of regulation will turn on whether a cabotage company is established in the UK but that you do not wish to define the meaning of "established" for fear that you will be accused of going wider than the Treaty of Rome and cases will be brought in the ECJ. While I understand your concern, I see no way in which the courts could implement the legislation without a definition of "established". Furthermore, since the meaning of the word would be unclear, the central offence of trading when not "established" would contravene the fundamental requirement that an offence should be drafted sufficiently clearly that potential offenders are able to judge in which circumstances they would contravene the law. The courts must be able to entertain and the defendant to adduce arguments and evidence as to whether a company is or is not established and for that purpose the statute must provide a basis

/for

The Rt Hon Paul Channon, MP

for interpretation. I am sure you will agree that we cannot have offences which give the courts no basis on which to make consistent and equitable decisions.

Provided that you can give me the assurance I seek on the first point, I would be happy for you to announce in general terms at Commons Second Reading your intention to introduce amendments to your Bill to regulate cabotage. Discussions between our officials on the formulation of the offences and the penalties could then continue.

I am copying this letter to the Prime Minister, members of OD(E), Nicholas Ridley, Cecil Parkinson, James Mackay, Patrick Mayhew, Malcolm Rifkind and Tom King and to Sir Robin Butler.

Yours,

Doug '77.



TRADE: Shipping Cabotage
Jan 88

0.014



cc BG

ROYAL COURTS OF JUSTICE
LONDON, WC2A 2LL

Rt. Hon Paul Channon
Secretary of State
Department of Transport
2 Marsham Street
LONDON SW1P 3EB

CDG
27/1

26 January 1988

Dear Paul

SHIPPING CABOTAGE

topenc.

I refer to your letter of 21 January, which I received yesterday. You seek the agreement of OD (E) to your proposal to take an enabling power in the Merchant Shipping Bill which would allow you to restrict the provision of shipping cabotage services in United Kingdom waters to undertakings which have a "permanent presence" here. Such a restriction would be enforceable by criminal sanctions. By "permanent presence" I understand from officials that you intend to refer to undertakings that are established here - see article 52 EEC - although it is not proposed to incorporate a definition of that concept.

Article 52 provides Community undertakings with a right of establishment. In view of the difficulties to which I refer in this letter, I am afraid I must advise strongly against the immediate course you propose.

From the papers I have seen I do not regard the outstanding point on penalties as something that can be left for resolution at a later date. Without a definition as to what is to constitute establishment for the purposes of the proposed offence, the offence will be much too uncertain in scope to be acceptable.

Any definition of "established", however, would have to be so constructed as to stand the best chance of withstanding a challenge in the ECJ. A restrictive provision would make such a challenge virtually certain.



Your letter implies that you would define the degree of presence required for establishment as being a subsidiary or sole agent. While Francis Jacobs QC, in the context of the proposed article 170 proceedings against the five Member States referred to in your letter, has advised that the proceedings should be framed on the basis that in the maritime sector a permanent presence, in the sense of a subsidiary or sole agency, is necessary to constitute establishment, this position has been taken in order to avoid the contention that the proceedings were seeking to circumvent the exclusion of transport services from the services chapter of the Treaty. We cannot, however, assume that the Court will not take a less restrictive view of establishment; it is quite possible that it will do so. In that event a criminal offence similarly based would not survive.

I must urge, therefore, that you do not commit us to legislate until further thought has been given to the basis upon which a criminal provision could be drafted and defended. I fully understand the need for early action with the objective you desire, and I should be glad to assist in the consideration of the problem.

I am copying this letter to the recipients of yours.

Lawson,
Salvick

H M ATTORNEY GENERAL

TRADE: shipping Cabstage Jai's



DEPARTMENT OF TRANSPORT
2 MARSHAM STREET LONDON SW1P 3EB

My ref:

Your ref:

The Rt Hon Sir Geoffrey Howe QC MP
Secretary of State for Foreign &
Commonwealth Affairs
Foreign & Commonwealth Office
Whitehall
LONDON
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GCPC
Amal FCS
comments

21 JAN 1988

Dear Geoffrey

SHIPPING CABOTAGE

I am writing to you with proposals for tackling the gross inequity whereby foreign carriers can compete freely in the UK coastal trades - known as cabotage - while British vessels are denied access to these trades in the five Community countries of France, Italy, Greece, Spain and Portugal. Non-British flag operators have some 40% of the UK cargo coastal market. The opening of the reserved cabotage trades, including offshore supply shipping, was the one notable provision that we were unable to secure in the package of EC shipping measures carried through by John Moore in 1986.

Successive Ministers have declared that the Government was not prepared to tolerate the continued denial of access to our vessels while we maintained open doors to the most important domestic shipping market in the Community.

Over the last year, we have been studying - and this has been announced in Parliament - the possibility of mounting a case before the European Court of Justice against those Member States (essentially those in the southern half of the Community, and including France) who reserve cabotage and offshore traffic to vessels flying their own flag. Counsel has advised that we have a good case based on Article 52, the right of establishment, provided it is accepted that any person or company wishing to exercise those rights is properly established, in the sense that they have a permanent presence in the state concerned.

The General Council of British Shipping are very disappointed to learn of this condition. They say that their members would see little value in a Court judgement that entailed their having to go to the expense of setting up a subsidiary or sole agency in order to operate on other countries' coasts. Until there is complete freedom to provide shipping services, their main interest is in reducing overall costs by earning revenue on the occasional domestic legs of what would be for the most part multi-port international journeys. For this reason, and because there would be some awkwardness in arguing the case in such a way as not to risk damage to our civil aviation interests, I do not believe we can proceed with a case before the ECJ.

How then can we honour our undertaking to act on this problem? It would hardly be enough to say that we were returning to the negotiating table, even though the Germans have, at our specific request, put the subject on the agenda for their Presidency, and there is now the possibility of using majority voting to force a decision. We have no cards to play in this negotiation other than the European Council declaration of intent on the completion of the internal market by 1992. That in itself is hardly enough.

My proposal is to use the Merchant Shipping Bill, which has its Second Reading in the Commons on 28 January, to take an enabling power, for use in the event of the negotiations not coming to an early and satisfactory conclusion, which would require all companies wishing to serve our coastal or offshore supply trades to have a permanent presence in the UK. Counsel's advice on the possible ECJ case makes it clear that this would be wholly in line with the Treaty; and I understand the only risk of challenge would be on the grounds that we were creating a new offence (with no doubt stiff penalties attached) and that there would be uncertainty for EEC citizens about the circumstances in which they might be deemed not to be established. This uncertainty could be removed by obtaining a certificate of establishment from the authorities, although this might be regarded as a barrier to the exercise of the right of establishment.

I am firmly of the view that we should accept any risk there might be that we would be taken to the ECJ. It is hardly likely that an action would be started before we had sought to use our powers, and the whole point of an enabling power would be to use the threat of eventual implementation as an incentive to those Member States whose shipowners wished to continue trading on our coasts, to negotiate seriously and quickly.

I understand that officials have discussed the proposals and some doubts may still remain. Questions have been asked about the value of the measure if we are forced to implement it. I judge that British vessels might increase their share of the market by about 5% and obtain somewhat better rates than they are able to obtain at present against subsidised competition. If by this means we can help to halt the steady decline in the British short-sea fleet, the initiative will have been well worthwhile.


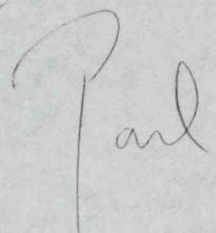
A second concern was over the impact of this measure on our overall posture on the completion of the internal market or the wider liberalisation of service trades. The first point can be met by reference to the strategic role of the shipping industry (our anxieties about the implications for national defence of the overall decline of the fleet are the subject of Ministerial correspondence at the moment) and this means that we cannot necessarily afford to deal with shipping problems in the same time scale as internal trade in general.

On the wider scene, our unique situation, of having a large market open to all-comers, is well-known; and we will be applauded by many declining to imitate the great majority of countries - many with otherwise liberal shipping policies, such as the USA, Canada, Australia and Japan - who reserve coastal trades to vessels flying their own flag.

I should be grateful for your agreement and that of other members of OD(E) that Counsel should be instructed, on the lines already discussed by officials, to prepare an appropriate clause for introduction as an amendment to the Merchant Shipping Bill in Committee. There is an outstanding point on penalties which I hope can be resolved in further discussion with Home Office at official level.

I should like to make a statement of our intentions on this important issue on Second Reading on 28 January, and I should therefore be grateful for replies by 26 January.

I am sending copies of this letter to the Prime Minister, to all members of OD(E), to Douglas Hurd, Nicholas Ridley and Cecil Parkinson, and to Sir Robin Butler.


PAUL CHANNON


Grey Scale #13



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