



CONFIDENTIAL

P.01216

PRIME MINISTER

The Airbus A320 Project

(E(A)(84)4 & 5)

BACKGROUND

British Aerospace (BAe) is a 20 per cent partner in Airbus Industrie (AI), the European consortium which produces the A300 and A310 wide-bodied aircraft; the other main partners are French and German. AI proposes to launch a new aircraft, to be known as the A320: orders have indeed already been taken from a number of airlines, including British Caledonian. BAe wishes to take part in the A320 and has applied to the Government for launch aid to cover the whole of its development costs: these would amount to some £460 million spread over the period between now and 1991.

Flag A

2. The note attached to E(A)(84)5, which I have prepared as Chairman of the Official Group on Aerospace, summarises the main considerations affecting this application, brings out the common ground and areas of difference among departments, and identifies the issues for decision by Ministers.

Flag B

3. In his memorandum (EA)(84)4, the Secretary of State for Trade and Industry recommends that the Government should back the project, but that launch aid should be provided on a smaller scale than requested by BAe. He seeks authority to negotiate assistance of up to £220 million; he would consult the Chancellor of the Exchequer as negotiations proceeded about the terms of the assistance and its repayment. Mr Tebbit argues that the UK should not pull out of this section of the civil aircraft market, as would be the consequence of a failure to

CONFIDENTIAL



CONFIDENTIAL

participate in the A320; and that although the likely rate of return on the project is "comparatively poor" and "low compared to the risk involved", participation is justified when wider industrial and political considerations, including the effect of failure to participate on our relations with the French and German governments, are taken into account.

4. The Chief Secretary, Treasury is opposed to participation.

Flag C
In his minute of 31 January, he argues that the prospective rate of return is inadequate; that backing the project would make it much harder to resist the claims of other industries looking for Government support; that there is little likelihood of valuable technological "spin-off"; and that there is little relationship between the A320 and the V2500 engine.

MAIN ISSUES

5. The issues before the Sub-Committee are as follows:

i. Should the UK, through BAe, participate in the A320?

ii. If so, should launch aid be offered? Of what amount and on what terms?

iii. How and when should the Government's decision be made public?

Should we participate in the A320?

6. As paragraphs 6 and 7 of E(A)(84)4 - and, in more detail, paragraphs 1.9 to 1.13 of E(A)(84)5 - show, it is not in dispute that, taken in isolation, the prospective financial return on the A320 is not satisfactory, especially bearing in mind the risky nature of the project and its long pay-back period.

CONFIDENTIAL



CONFIDENTIAL

7. It would no doubt be possible to argue at length about the most likely "central estimate" of the rate of return. Mr Tebbit suggests that it is "around or marginally below 5 per cent" but this rests on an assumed dollar exchange rate (\$1.50 : £1) which many, including BAe themselves, would regard as optimistic. It also assumes achievement of a 19 per cent improvement in production efficiency; MoD(PE) regard this as attainable by BAe but it remains a risk. The Chief Secretary suggests that the "more probable outcome seems likely to be no more than zero and it would not take much to cause the return to become negative". But this rests on a lower sales estimate than the DTI's (450 rather than 600) which many would regard as unduly pessimistic; and he also implies some risk of cost escalation on the development programme whereas MoD(PE) consider any serious overrun at the development stage as unlikely since this programme derives mainly from existing techniques.

8. The Sub-Committee may therefore feel that the best assumption, against a background of inevitable uncertainty, is that the rate of return will be somewhere between the figures deployed by Mr Tebbit and the Chief Secretary, ie a small positive return, considerably less than 5 per cent. Since this is inadequate, the decision must turn on the strength of the wider considerations.

Wider considerations

9. The main wider considerations are:
- a. implications for civil airframe manufacture;
 - b. technological "spin-off";
 - c. international implications.

CONFIDENTIAL



CONFIDENTIAL

Implications for civil airframe industry

10. It seems clear that if BAe failed to participate in the A320, the eventual outcome would be withdrawal by the UK from the design and development of large civil airframes. The UK would be taking a different view from several of our main industrial competitors, including France, West Germany and Japan who are seeking to increase their capability in this area.

11. On the other hand, civil aircraft projects and civil aircraft manufacture have an unhappy history. The BAC1-11 and the Hawker Siddeley Trident were the last British aircraft intended for the main airline routes; neither is believed to have made money. The Douglas Aircraft Corporation went bankrupt and had to be taken over by McDonnells; the amalgamated company got into serious trouble with the DC-10, and there is some doubt whether it will continue in the civil market. Even Boeing nearly went bankrupt over the 747. AI has won its present market share, in large measure, through subsidies from the French and German governments. On the face of things, the manufacture of civil aircraft should be an industry of the future, but its record to date is not encouraging.

12. It may be suggested that even if BAe did not participate in the A320, the UK would still be free to get future sub-contracting work, like Shorts on the B747 and 757. That is no doubt true, in general terms. But it is almost certainly not true of the A320. Hawker Siddeley were sub-contractors on the A300. The French and Germans resented that fact and were adamant during negotiations on the A310 that sub-contractor status on that aircraft was not open to BAe. They would be almost certain to take a similar line on the A320.

CONFIDENTIAL



CONFIDENTIAL

13. If BAe were to withdraw from large civil airframe manufacture, there would remain the smaller end of the civil market in which the BAe146 is now competing and the ATP (Advanced Turbo Prop) project might give BAe a presence in the future. Arguably it might be a more realistic strategy to concentrate future efforts in that sector but it should be borne in mind that BAe would be more exposed to competition in the smaller aircraft from the newly industrialised countries.

Implications for the rest of the aerospace industry

14. If the UK were to withdraw from the manufacture of large civil airframes there would inevitably be consequences for our civil aircraft equipment industry. Participation in the A320 will not guarantee equipment orders: British firms will still have to be competitive. But experience on previous AI programmes indicates strongly that if BAe do not participate in the A320, UK equipment manufacturers will stand little or no chance of substantial orders from AI. The DTI have not been able to quantify the business which might be at risk. It could be argued that the loss of a UK presence in the mainstream of civil airframe manufacture is something which UK suppliers ought to face up to sooner rather than later. But a Government decision not to back the A320 would undoubtedly be badly received in the equipment industry.

15. The implications for aeroengines are less important. As the Chief Secretary points out, the success of the V2500 does not depend to any great extent on the A320. My note (E(A)(84)7) on the V2500 makes clear (paragraph 1.5) that the major part of the assumed sales of that engine are in US airframes. Moreover engine selection rests with the airlines.

See Item 2
on Agenda

CONFIDENTIAL



CONFIDENTIAL

Technological "spin-off"

16. Dr Nicholson will be letting you have a separate note on the technological aspects of the A320 and V2500. Although the Chief Secretary is wrong to suggest that wing development is not a high technology activity, it is true that participation in the A320 is unlikely to yield any substantial technical spin-off.

International implications

17. Although there are some wider economic considerations arguing in favour of the A320, many Ministers may find them insufficient to tip the scale. In addition however there are some wider international political considerations of which you are well aware. The French and Germans would undoubtedly regard refusal to participate in the A320 as a serious rebuff, and as confirmation of what they allege is the UK's "non-Community" attitude. The considerations are set out at length in paragraphs 12 and 13 of E(A)(84)4 and paragraphs 2.5 and 2.6 of E(A)(84)5. Although the UK could argue that the test of commercial viability, which we have consistently emphasised, has not been met, the French and Germans are most unlikely to agree with us.

Launch aid

18. If Ministers decide that the UK should participate in the A320, it will be necessary to decide the terms and amount of launch aid. It is not in dispute among departments that launch aid on a substantial scale will be needed, but that in order to ensure that BAe itself has a proper stake in the success and efficient management of the project, launch aid should not be provided on a scale greater than about 50 per cent of total launch costs. There is also (see Section III of E(A)(84)5)

CONFIDENTIAL



CONFIDENTIAL

much common ground about the terms and conditions of launch aid and its recovery.

19. The main issue before the Sub-Committee is likely to be the quantum. Mr Tebbit asks for authority to go up to £220 million; the Chief Secretary, Treasury is likely to be advised to argue for about £185 million (40 per cent of total launch costs). The Sub-Committee may well feel that if the political and other considerations outlined in the papers justify UK participation at all, it would not be wise to constrain Mr Tebbit's negotiating room too tightly for the sake of (at most) £35 million. The advice of Morgan Grenfell (report circulated under cover of a letter from Mr Tebbit's private secretary of 31 January) is that BAe would be unlikely to proceed on the basis of launch aid much less than 50 per cent, but should be willing to go ahead if launch aid of around 50 per cent were made available.

20. The Morgan Grenfell report also suggests a way of channelling the launch aid to BAe through a private sector company with Government guarantees. Although this would reduce public expenditure in the short term, it would increase the costs to the Government, and it is unlikely that the Treasury would see any advantage in this approach. If anyone sees merit in the Morgan Grenfell proposals, it would be better for Mr Tebbit and the Chief Secretary to pursue it outside E(A). It should not be allowed to complicate the main decision on whether the Government should support the project.

Announcements

21. Although the matter of announcements is not discussed in E(A)(84)4, the Sub-Committee will need to address it. There will be strong pressure for an early statement of the Government's view from AI, BAe and the French and German

He hinted yesterday at coming back to E(A) for £30 million & BAe do not accept £220 million.

Flag D
No need to read this.

Use of guarantees to avoid public expenditure is a dangerous game ✓

CONFIDENTIAL



CONFIDENTIAL

governments; and there are in fact good industrial and commercial reasons for such an announcement, since it will enable AI to finalise work sharing arrangements and to present prospective airline customers with an aircraft about whose future there is no doubt. On the other hand, once it became known that the Government had decided to back participation by BAe, it would be hard to negotiate a satisfactory deal on launch aid. The Sub-Committee will probably feel that the right course is to try to reach agreement with BAe on the main points, though not necessarily every detail, and until such agreement is reached (if it is) to make no announcement and to maintain the line in public that the project is still under discussion with the industry.

See M. Tebbits
personal minute

HANDLING

22. You will wish to invite the Secretary of State for Trade and Industry to introduce his memorandum; the Chief Secretary, Treasury might then be asked to reply. The Foreign and Commonwealth Secretary will be able to advise on international aspects. The Secretary of State for Wales has a departmental interest, since BAe's main Airbus factory is just over the Welsh border from Chester. The Minister of State, Ministry of Defence (Mr Pattie) is attending in the absence abroad of the Secretary of State for Defence.

CONCLUSIONS

23. You will wish the Sub-Committee to reach conclusions on:
- i. whether the UK, through BAe, should participate in the A320 project;

CONFIDENTIAL



CONFIDENTIAL

ii. if so, what maximum amount of launch aid should be offered to BAe and on what terms;

iii. announcements.

PLG

P L GREGSON

1 February 1984

CONFIDENTIAL