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PRIME MINISTER

I am afraid that I cannot attend E(A) on Monday to discuss the A320 due to an unavoidable prior engagement.

Although, as Environment Secretary, I now have no Departmental interest in this project, I did handle a good deal of the earlier consideration before the Election. Perhaps I may therefore offer some comments.

From the outset, it has been clear that British participation was always going to be no more than marginally profitable. I believe the main reason for this is that the extra costs involved in the kind of international collaboration represented by Airbus Industrie are very substantial as compared with the construction of a comparable aircraft by a single company such as Boeing. Sir Austin Price once hazarded to me the guess that the extra cost could be as much as 60%. This is not because components are fabricated in widely separate locations and then assembled at the final assembly plant; I am told that all the American manufacturers use this technique. The extra cost arises because of the delays and compromises inherent in a project where independent companies based in different countries and mostly relying on the support of their Government have to take decisions. The quite extraordinary system of costing that has been used hitherto by Airbus Industrie is simply evidence of the inability of the individual companies and their Governments to agree on anything better.

I believe that it is primarily this additional cost of research, development and design as well as the lower productivity records of most of the European companies which accounts for the poor profitability. Selling prices have of course to be competitive with American aircraft. The resultant squeeze

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on margins is what makes this a highly marginal project.

This has certainly always been recognised by the ^{GERMANS} Chairman. At the several meetings which I had with Count Lambsdorff, we were united in agreeing that we did not want "a political aircraft". By that, we meant that there was no point in our companies and our Governments pouring large sums of money into a project which was never likely to show a return. The paper suggests that the Germans are now moving more strongly in favour of A320 and had I been present on Monday I would have wished to press Norman Tebbit and Geoffrey Howe as to the reasons for this. Although the risk/reward ratio looks marginally better than it did 9 months ago, it is still very unexciting. As the Treasury point out, the real return could turn out to be nil. Moreover, British participation is not essential to the project. If we pull out, I am advised that this will not prevent the A320 going forward so that we will not have to deal with an American monopoly in this aircraft size range. If therefore these were the only considerations, I would be firmly against supporting the project.

I have to say however I have simply not been exposed to the political pressure to which you made reference at the end of Thursday's meeting. Pulling out will lead to job losses (5,000 upwards) in BAE and suppliers both directly and because the airbus consortium will not favour British sub-contractors. It can certainly be argued that these job losses will be offset by gains elsewhere in the economy as the money that would have been used on this project is spent elsewhere so I would not put too much weight on that. Again, withdrawal would certainly be taken badly by our European partners as another example of our less than whole-hearted Europeaness.

I suspect that the real issue will be what it always has

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been - whether or not the British aircraft industry is to retain a foothold in the large civil airliner market. Although, 2 years back, BAE still had the hope that it might prove possible to bid for 30% of the A320 and secure assembly in Britain (and so secure a much higher proportion of British components) this was abandoned back in 1982. We are now left only with the main wings and no doubt, because of participation, a chance for a good many component suppliers to get work.

Despite all the arguments to the contrary, which I have rehearsed, and subject to what may be said at the meeting, I believe that the political case for continuing must prevail. I believe that the Government simply would be unable to defend pulling our industry out of this market which seems bound to remain one of the growth areas in the world economy. Although the economic returns are less than attractive, I would come down on the side of those who would take the view that they are not so bad that this should be the over-riding consideration.

The real issue then comes down to quantum. What I believe the Government should aim at is a contribution not £1 higher than is necessary to persuade BAE to go ahead. As a private company they will have every incentive to keep the development and production costs just as low as they can and to secure the major improvements in productivity which the management knows can be achieved. Only Norman Tebbit and his Department are really in a position to know what this figure is, and as with the Rolls Royce engine I believe we should leave it to him. He should be asked to come back to us in any event before we either agree to pull out or settle the final figure for launch aid.

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I am copying this minute to members of E(A), Geoffrey Howe, Michael Heseltine and Sir Robert Armstrong.

A.H. Davis

for
P J

3 February 1984

*Approved by the Secretary
of State and signed in
his absence*



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