REGD. No. S006 | 2016 X

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Department of Economic Development

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Your Reference

Our Reference

Date 7th July 1988

Dear Alan

HARLAND AND WOLFF: ESTIMATE OF CLOSURE COSTS

As requested I attach a year-by-year breakdown of our estimate of £240m.

I must emphasise that this is very much a ball-park figure and in view of this it is considered that a totally misleading view of his accuracy would be conveyed by the inclusion of this breakdown as an Annex to the E(A) memorandum.

Your attention is drawn to the notes on foot of the draft Annex already fowarded to you, in particular that the estimate was prepared without consultation with H&W and that the company are due shortly to produce revised cash flow forecasts for the next few years which may require revision of the estimate.

Finally, may I also make clear in case of misunderstanding that the maximum figure of £60m in any one year mentioned in the text of the draft memorandum refers only to negotiations with Mr Tikkoo and not to closure costs. As you will note, in the last two financial years of the period covered in the breakdown the estimated cost exceeds £60m, in one year by a very substantial margin.

Yours Ever
Denis

D J RITCHIE

cc Mr Semple
Mr Fell
Mr Gibson
Mr McDonnell
Mr McConnell
Mr Thomson

PS/10

HARLAND AND WOLFF: ESTIMATE OF CLOSURE COSTS

	1988/89	1989/90	1990/91	1991/92
Trading Support (incl.contract losses)	37	25	22	30
Specific Closure Costs				
Terminal Bonuses	-	-	20	-
Others - demolition, etc	-	-	8	10
Redundancies	13	15	32	28
TOTALS	50	40	82	68

PS/10

NIC/ICTU SEMINAR : THE SHIPBUILDING INDUSTRY IN NORTHERN IRELAND

FUTURE PUBLIC SECTOR SUPPORT FOR SHIPBUILDING : AN ECONOMIST'S VIEW

Dr Richard T Harrison, Lecturer in Applied Economics, University of Ulster at Jordanstown

INTRODUCTION

The general importance of Harland and Wolff both in the past and today has been summarised recently in the official history of the company, published in 1986:

> "it would be misleading to see aid from Government as being an entirely one-way transaction. The Company has been a demonstrably peaceable symbol of British commitment to Northern Ireland, generating a significant proportion of all employment in the Province's manufacturing sector. It has also been a leader in the United Kingdom shipbuilding industry, producing, in the largest construction yard in Europe, the biggest, the best and the most technically advanced products. Queen's Island has been a training ground not only for first-class shipbuilders and marine engineers but also for skilled workers and managers for the whole of Northern Ireland. The Company's purchases of materials and components - amounting to almost two thirds of the price of a ship - provide a market for hundreds of United Kingdom suppliers. The purchasing power of Harland and Wolff employees is of vital importance to the city of Belfast and to Northern Ireland as a whole".

BACKGROUND

In looking to the future, and in particular in considering future public support for shipbuilding in Northern Ireland, it is important to look back at past performance, which provides the context within which decisions are currently being taken.

Financial Performance

Much discussion, by Government ministers and officials and others, has concentrated on the recent figures produced by the company. However, the financial problems of the shipbuilding industry in Northern Ireland have been of long-standing severity. As Figure 1 indicates, Harland and Wolff has not made a profit on work carried out for over 20 years, and the scale of losses has increased in recent years. Several features of this performance stand out:

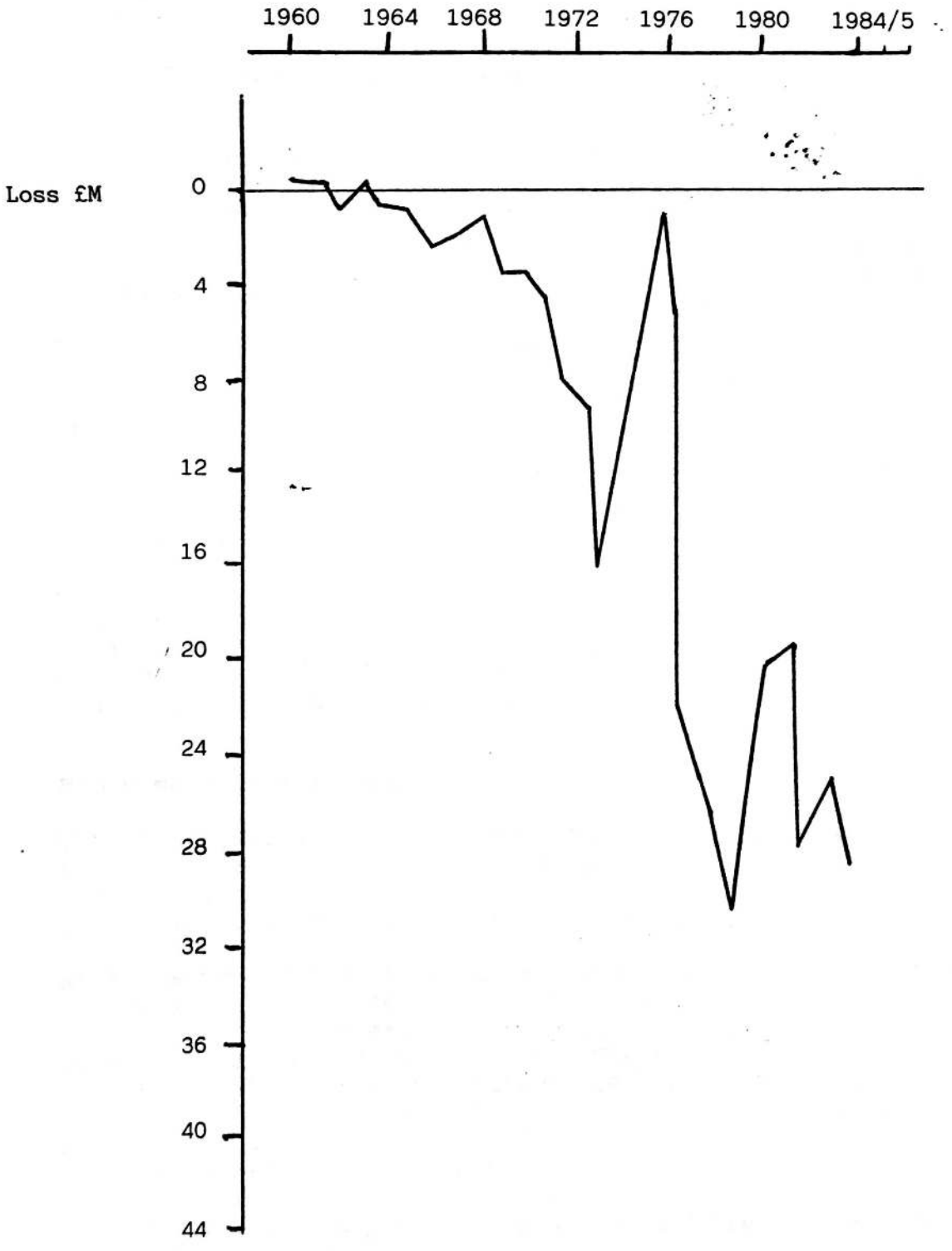


FIGURE 1 Harland and Wolff: Loss on Work Carried Out 1960-1986/7

1. Mounting losses in the early 1960s, following completion of the Canberra and some major naval and shiprepair contracts and the emergence of Japan as a serious competition for shipping orders, led to the first injection of public funds in Harland and Wolff in 1966.

2. Further losses were incurred in the late 1960s and early 1970s until the building dock and related facilities came on stream and the company had a full order book. By 1975-6 the company was almost breaking even on work carried out.

3. By the mid-1970s, however, the market for new ships, particularly in the product areas in which the company was specialising (VLCCs and bulk carriers), collapsed in the wake of 1973-4 oil crises and the world economic recession which followed. Since then the world shipbuilding market has been in crises, the company has had to diversify its product range and engage in significant restructuring in order to survive. The result has been that losses on work carried out have averaged round £25m annually since 1978.

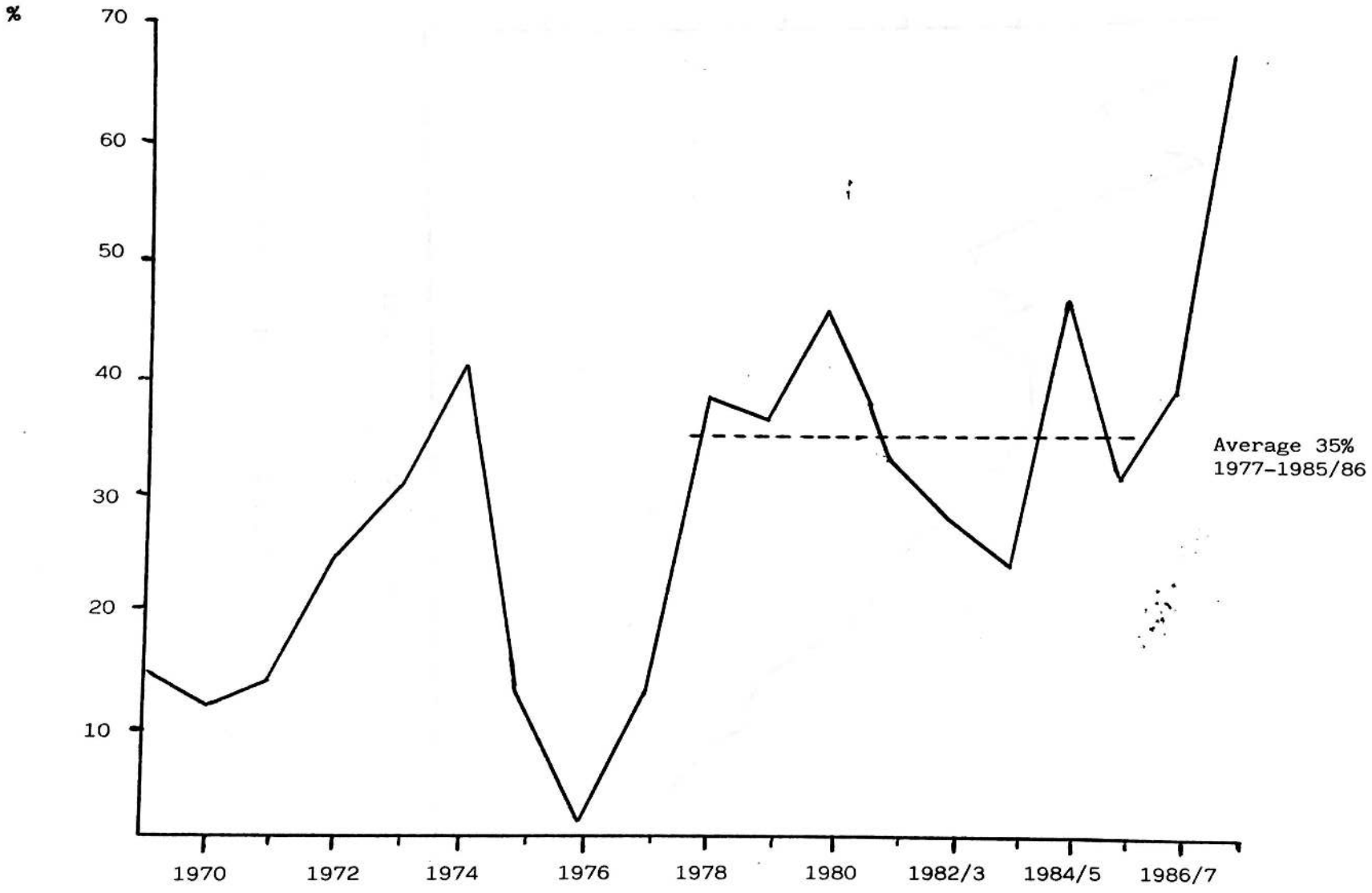
This measures the depth and severity of the crisis facing the industry in Northern Ireland. However, until 1987/88 the financial performance of Harland and Wolff has not apparently deteriorated in relative terms. Losses on work carried out can be expressed as a percentage of total turnover in each year (see Figure 2). The average loss has been about 35% of turnover since 1978, with fluctuations around a horizontal trend. However, in 1987/88 losses on work carried out rose sharply to around 68% of turnover. These losses were attributed in part to delays experienced with a major subcontractor. These losses had been anticipated in the previous year and provision was made to cover them in the 1986/87 accounts. When this provision is taken into account, the total deficit for the past year actually shows a sharp fall on the previous year (1986/87).

Employment Performance

This financial performance, together with major changes in the technology and organisation of shipbuilding production has been matched by a major reduction in employment over a long period of time. The figures are summarised in Figure 3.

At the start of the 1960s Harland and Wolff employed almost 25,000 in Belfast : following the completion of the Canbera, some naval work and some major shiprepair contracts, employment was reduced to around 13,000 in 1962. There was a further sharp fall in employment, to c.9,000, between 1966 and 1968. As VLCC construction in the new building dock expanded, this level of employment was maintained until 1974. Since then there has been a 50% reduction in employment to 5,000 in 1985 and a further 25% fall in employment to under 4,000 today. With further redundancies in the pipeline this downward trend seems set to continue into 1989.

FIG 2 Harland and Wolff Losses As Percent of Turnover



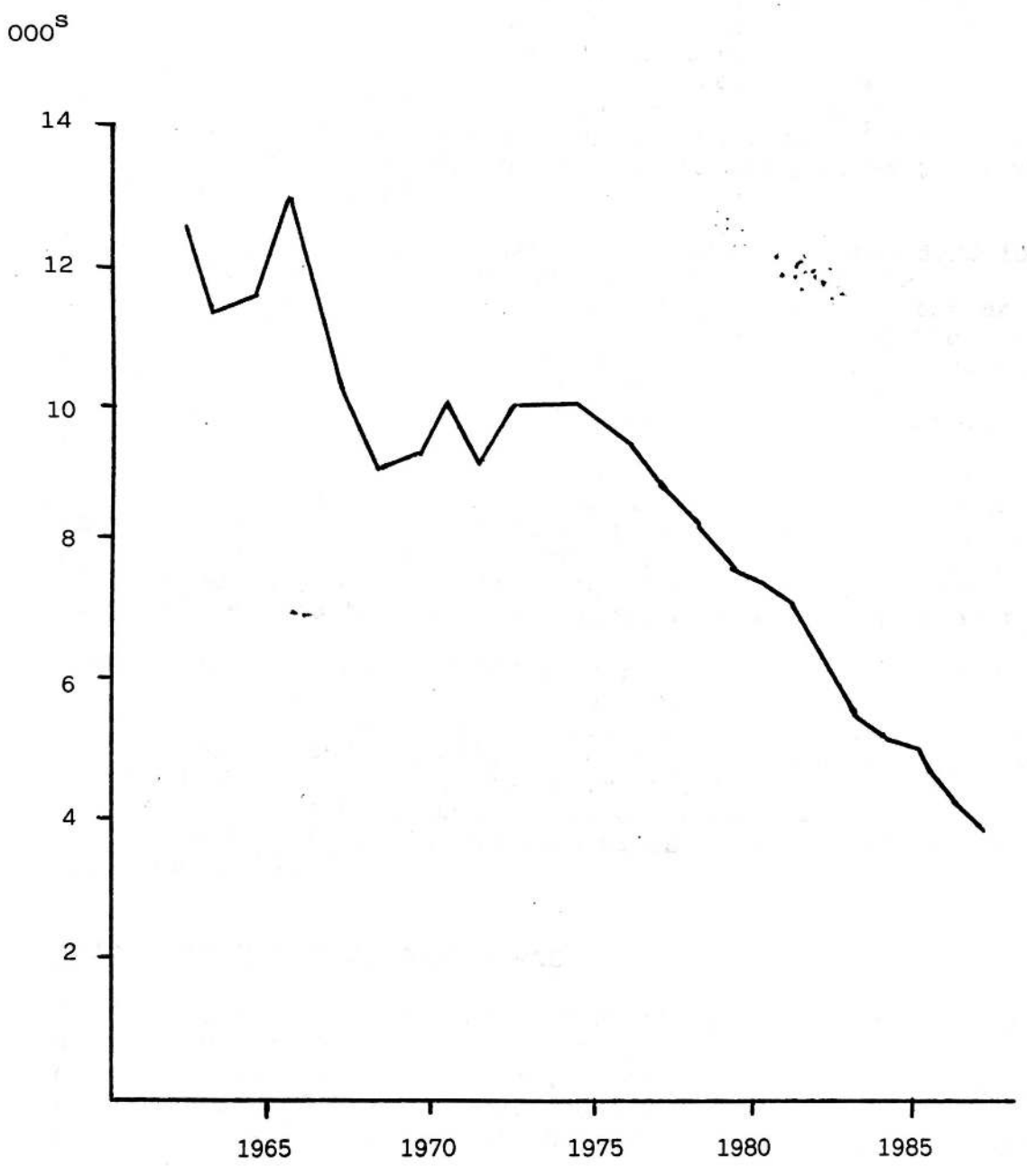


FIGURE 3 Employment in Harland and Wolff 1962-1987

Comparative Performance

This continued loss making performance is not unique, not is the loss of employment. In recent years shipyards in Japan and South Korea, the market leaders in terms of tonnage produced, have anounced significant losses, as have the surviving British and European yards. In many cases the level of losses per employee exceed those incurred in Belfast in recent years. While the level of losses in Harland and Wolff remains significant, and represents a threat to the long term survival of the industry here, Harland and Wolff is by no means the poorest performing shipyard in the world.

A comparison with the situation in British Shipbuilders is instructive, though given the recent history of the privatisation of the remaining merchant yards in Great Britain this comparison is not necessarily an indicator of the likely survival of Harland and Wolff in its present form. Nevertheless, the figures in Figure 4 indicate that over a five year period the performance of Harland and Wolff has compared very favourably with that of British Shipbuilders (continuing activities, ie, excluding from the calculations all data relating to yards privatised or otherwise disposed of up to 1985-86). This is true whether the measurement is made of losses relative to turnover or per employee. The calculations have not been extended beyond 1985/86 because of the difficulty of obtaining adequate comparative data to make comparisons worthwhile and meaningful.

The figure of almost £14,000 loss per man in British Shipbuilding in 1985/86 actually underestimates the magnitude of the problem : if redundancy and other restructuring costs are included (as they are in the Harland and Wolff accounts) the loss per employee rises to £18,000, and if the restructuring costs borne by BS following the sale of Scott Lithgrow and the warship building yards are also included the loss rises to around £42,000 per employee in 1985/86.

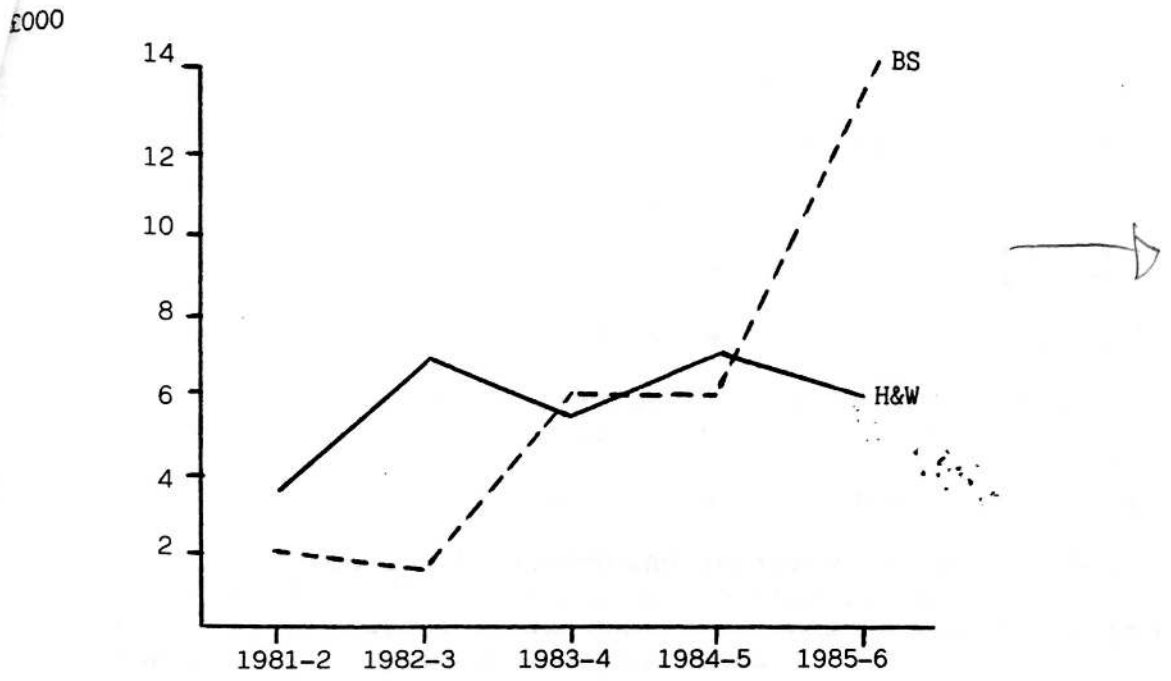
GOVERNMENT FINANCIAL ASSISTANCE

In view of the scale of losses over the past 20 years it is not surprising that Government assistance has been considerable. Assistance was first provided in 1966 as part of the financial restructuring of the company, and Government involvement progressively increased, culminating in full public ownership in 1975.

In order to present an accurate picture of the total level of commitment of assistance to the industry the following figures are presented in terms of 1981 prices (ie the actual amounts paid in each year in cash terms have been recalculated in terms of their value in terms of 1981 prices).

The figures for the past twenty years are as follows:

(a) Trading Loss Per Employee



(b) Trading Loss as Percent of Turnover

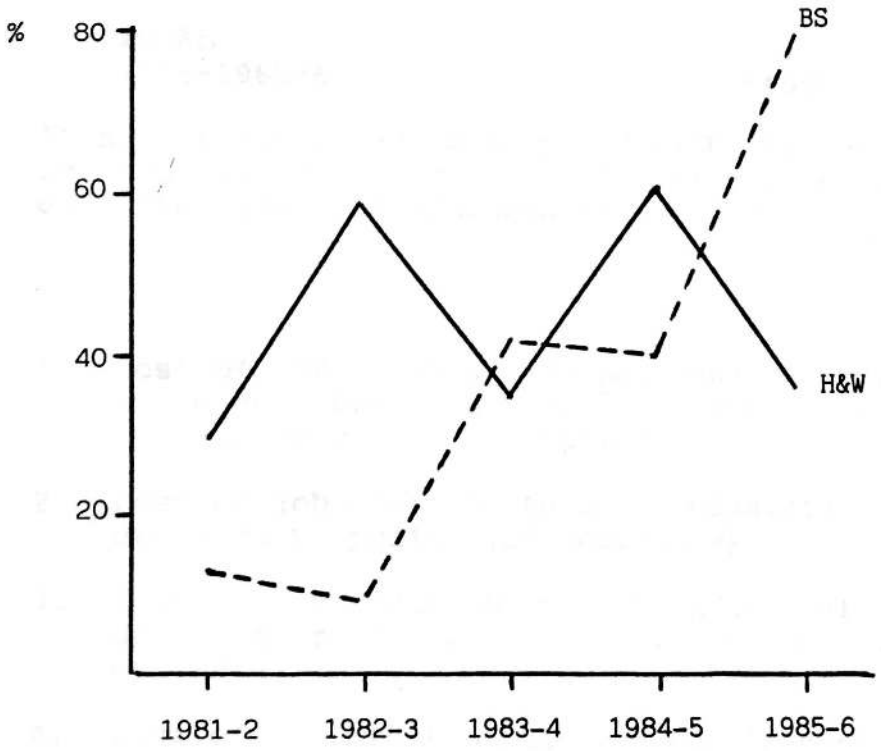


FIGURE 4 Financial Performance in Harland and Wolff and British Shipbuilders

	Total Assistance	Average Assistance per year
	(All figures are in constant 1981 prices)	
1966-71	£228.6m	£38.1.
1972/3-1981/2	£366.3m	£36.6m
1982/3-1985/6	£165.0m	£41.3m
TOTAL	£759.9m	£38.0m

Prices. 1988

£57.m

On the basis of these figures, the scale of government assistance in recent years (excluding the most recent two years for the time being - see below) has not been significantly different from that made available in the late 1960s on an average annual basis.

These figures can be expressed in terms of what it has cost Government in direct terms to maintain employment in Harland and Wolff by calculating the cost per job maintained per year (again constant 1981 prices have been used):

	Cost per job per year (1981 prices)
1966-71	£3901
1972/3-1981/2	£4179
1982/3-1985/6	£7562
TOTAL 1966-1985/6	£4500

These estimates can be compared with the average costs per job created through other forms of public expenditure. Some relevant estimates can be summarised as follows:

	Cost per job per year
1. Cost of job creation and maintenance in the man-made fibres industry in NI 1959-1982 (NI Economic Council Estimate)	£4,000
2. Cost of job creation through industrial development policy (DED estimate)	£2,000-£4,000
3. Cost of job creation through industrial development policy (University of Cambridge estimate)	£10,000
4. Cost of job creation through public expenditure on selected employment and training measures (NIEC estimate, 1984)	£4,000-£6,000

5. Cost of job creation through public expenditure on other programmes, eg, health, education, infrastructure (NIEC 1984 estimates) £10,000-£26,000

These are average costs, calculated for a period of time in most cases. In the case of the last two categories the estimates are based on a calculation of the employment content of public expenditure and represent estimates for one year : without the continued public expenditure the jobs supported would disappear.

However, in the last two years (and Government forecasts for 1988-89 suggest that the recent trend will continue) Government assistance to shipbuilding has risen substantially. The cost per job implied by these recent figures is around £15,000. It is, however, misleading to concentrate on this one figure for a number of reasons:

1. There is no reason to suppose that the level of financial assistance to Harland and Wolff has shifted permanently upwards to a new level. Indeed, given a sufficient volume of work in the yard (to allow overhead costs to be recovered and efficiency and productivity savings to be maximised) the level of support required would be expected to fall.

2. Much of the recent assistance to Harland and Wolff has been associated with the very sharp reduction in employment in the company in the last two years : restructuring and redundancy costs have been significant. However, these costs can be viewed as a one-off item designed to restore the competitiveness of the shipyard. From the aggregate economic point of view it makes as much sense to view these costs as an investment in the future of the facility (by reducing costs) as it does to view them as a drain on public funds.

3. Although we can estimate the total cost per job supported in Harland and Wolff last year we are not able to carry out the same calculation for job creation through the industrial development programme. The experience of the IDB has been that new inward investment has been very scarce, and the cost of attracting these jobs has been very high and is rising as development agencies throughout the world attempt to outbid one another for the projects available. Domestic investment supported by the IDB is increasingly capital intensive, as companies attempt to reduce costs, particularly labour costs, to maintain competitiveness. Even at present levels of support, therefore, it is not necessarily the case that job preservation in Harland and Wolff is more expensive to Government than new job creation through new inward investment or the restructuring of other local companies.

Indeed, the data in Figure 5 suggest that expenditure on assistance to industry (excluding shipbuilding) in NI by 1988-89 will be lower than in any year since 1978-79. Even if the high recent levels of assistance to shipbuilding is included the total

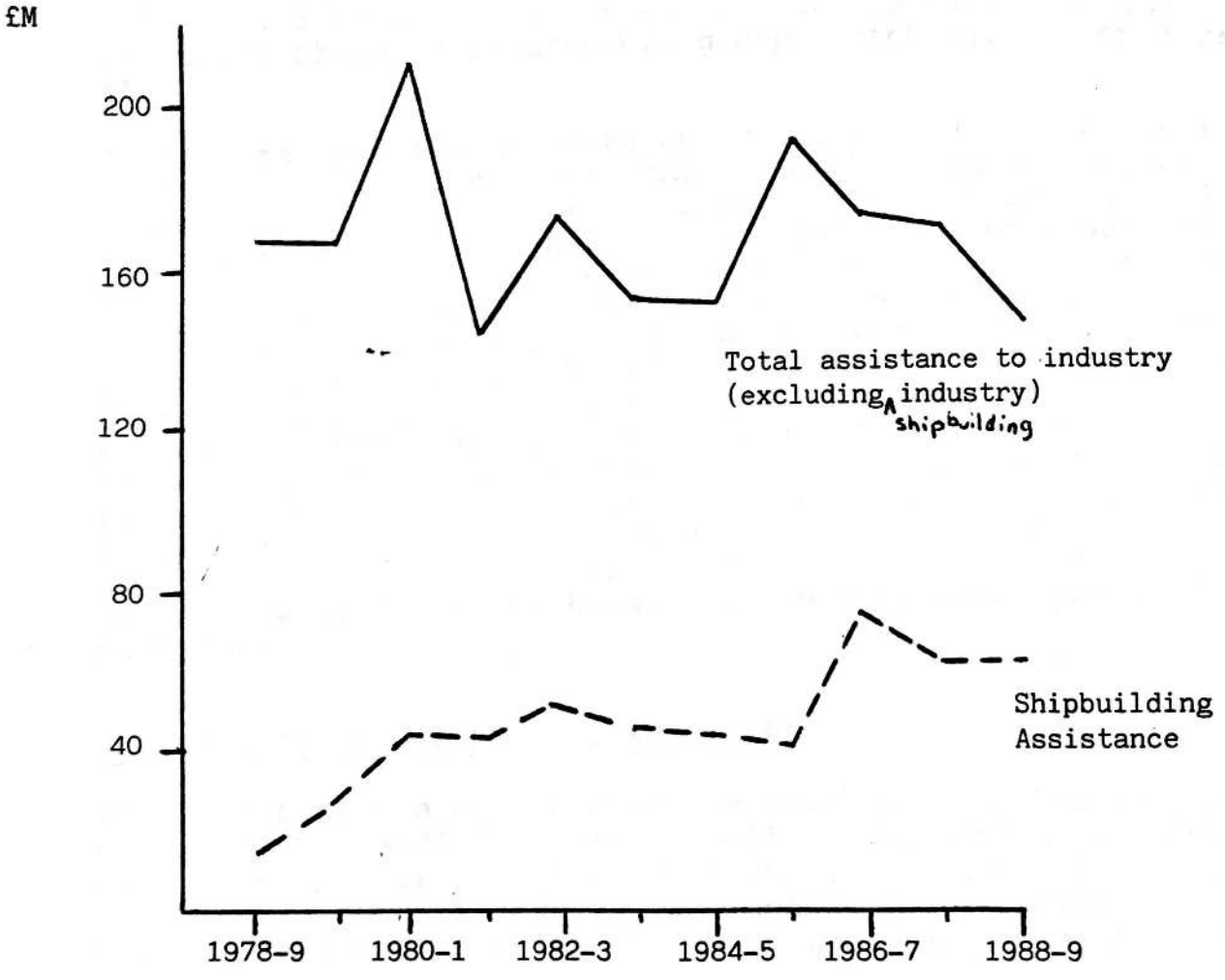


FIGURE 5 Assistance to the Shipbuilding Industry and to other Industry in Northern Ireland

support for industry in NI (excluding training and labour market services) will have fallen by almost 15% in cash terms between 1986-87 and 1988-89. This does not offer support for the argument that assistance to shipbuilding is automatically at the expense of expenditure on other programmes. It certainly does not appear to be at the expense of other forms of industrial support (offered through the IDB and LEDU primarily) which would satisfy the requirements of DED's "pathfinder" initiative to direct public subsidies away from activities that are merely supportive of the local economy to those that strengthen it.

Nevertheless, it must be acknowledged that assistance to shipbuilding does represent a considerable part of total Government assistance to industry (See Figure 6). Over the last 10 years, and including the estimates for 1988-89, Harland and Wolff's share of total industrial support has averaged about 20% per year, rising to 30% currently. At the same time the company's share of manufacturing employment has fallen from 6% to 4%.

In all its recent statements on public expenditure priorities in Northern Ireland the Government has emphasised that after law and order, the economy (and industrial development in particular) has top priority. In the absence of a high level of inward investment and in view of the small manufacturing base of the local economy, the shortfall of expenditure on the industrial development programme has made it possible to devote resources to continued support for Harland and Wolff. For present levels of support to continue, however, it must be clearly demonstrated that such support for the shipbuilding industry is justified on the grounds of cost (relative to other forms of industrial development expenditure), efficiency (it is easier to maintain 3000-4000 jobs which already exist than to create the same number of jobs in a new project or projects) and prospects (that the level of support required will reduce or be eliminated over some specified period of time).

ECONOMIC IMPACT OF HARLAND AND WOLFF

The impact of the shipyard on the local economy has recently been examined by the NI Economic Council, using data on purchases of materials and services for the past three years. Based on the NIEC analysis and my own calculations the employment impact of the shipyard can be estimated as follows (as of March 1988):

1.	Dirct shipyard employment	4000 jobs
2.	Indirect employment in supplier firms in Northern Ireland	500 jobs
3.	Income multiplier effect, arising from local expenditure of wages and salaries	1200 jobs

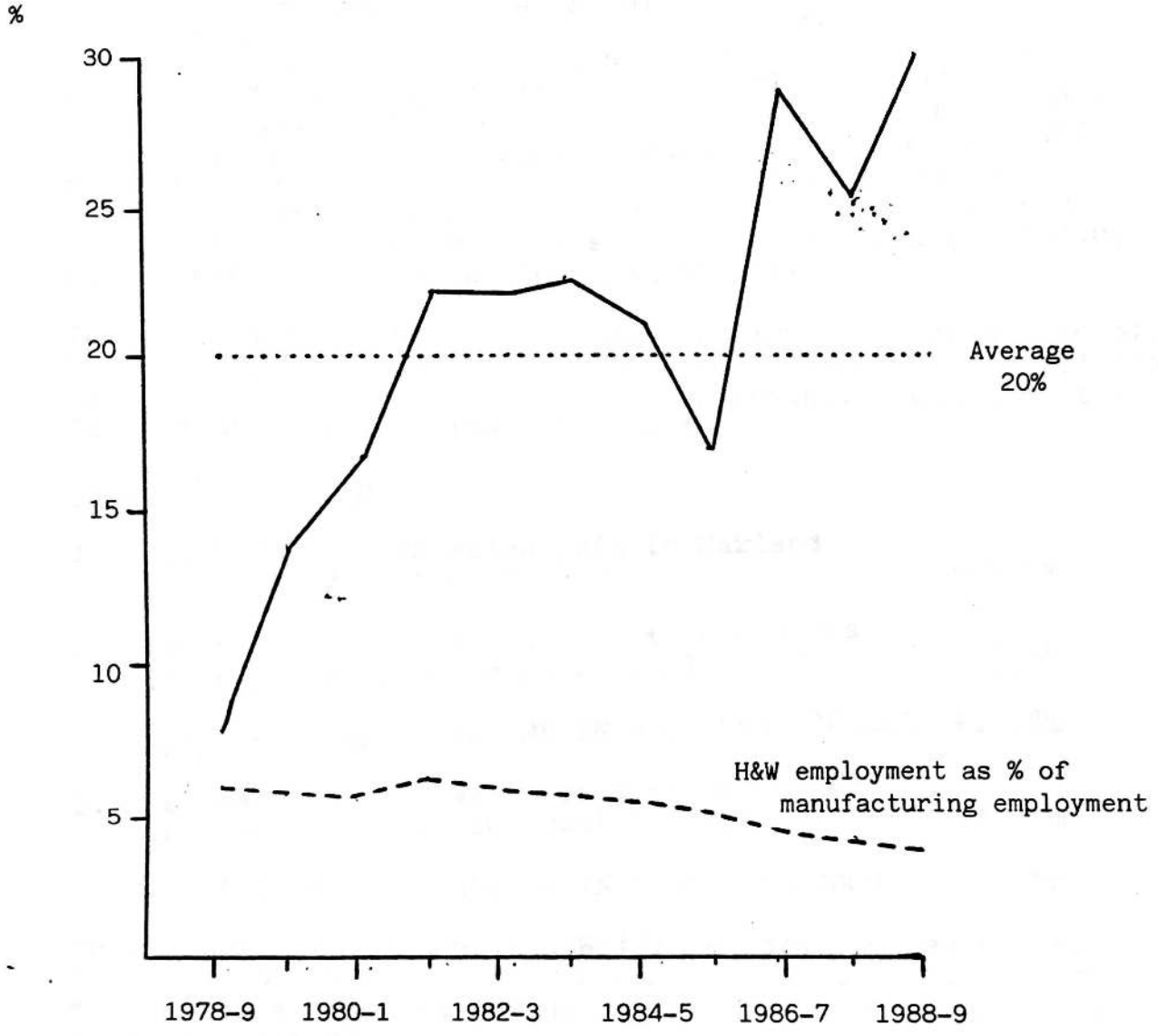


FIGURE 6 Assistance to Shipbuilding as Percent of Total Assistance to Industry in Northern Ireland

TOTAL HARLAND AND WOLFF RELATED EMPLOYMENT IN NORTHERN IRELAND	5700 jobs
4. Indirect employment in supplier firms throughout Great Britain	4000 jobs

It must be emphasised that these figures are estimates : however, the procedures used in the calculations, and the assumptions made, are standard in regional economics and the estimates can be viewed as reliable. The NIEC has recently suggested that its estimate of the Northern Ireland related impact should be revised downwards to c.4500 jobs, reflecting both lower direct employment in the shipyard and lower local expenditure on materials and services in the past year. Such fluctuations are to be expected : as a working basis we can assume that between 8500 and 9000 jobs in the UK as a whole depend on the shipyard (including direct employment in the shipyard itself).

This employment has a considerable impact on revenue generation, both in terms of household disposable incomes (net of all tax and national insurance payments) and tax revenues generated for Government (based on 1987-88 data):

Disposable Income

1. Net wages and salaries paid to Harland and Wolff direct employees	£28.5m
2. Net wages and salaries paid to employees in supplier firms in Northern Ireland	£3.3m
TOTAL DISPISABLE INCOME IN NORTHERN IRELAND	£31.8m
3. Net wages and salaries paid to employees in supplier firms in Great Britain	£23.7m
TOTAL DISPOSABLE INCOME IN UNITED KINGDOM	£55.5m

In other words, Harland and Wolff in total represents the injection of over £55m in consumer spending power (after tax) in the United Kingdom as a whole, almost £32m of which is spent in Northern Ireland.

Tax Revenues

1. Income tax and national insurance from Harland and Wolff employees	£12.2m
2. Income tax and national insurance from employees in supplier firms in Northern Ireland and Great Britain	£11.5m
TOTAL TAX REVENUE RECEIPTS	£23.7m

In other words, the Government nationally gains almost £24m in tax revenues (income tax and national insurance) from the continued support of Harland and Wolff and through it, the supplier firms in Northern Ireland and Great Britain. This is equal to almost half of the subsidy received in the past two years and represents around 60% of the average level of subsidy in the years 1980-81 to 1985-86. Put another way around half of the annual subsidy from the national exchequer in London is immediately returned to London in the form of tax receipts from the employment created, and half of these tax receipts arise from employment supported indirectly in Great Britain.

Emphasis on the Great Britain dimension to the economic impact of Harland and Wolff both in terms of consumer disposable income generated in Great Britain and tax revenues raised nationally through the direct and indirect employment created is a major feature of this analysis.

FUTURE OPTIONS

From the recent discussions of the future of the shipbuilding industry in Northern Ireland there appear to be four possible development strategies:

1. Continued public ownership
2. Privatisation
3. Management/employee buyout
4. Closure

Continued Public Ownership

The Government has made it abundantly clear recently that continued public ownership of Harland and Wolff is not an option. Intervention fund subsidies and support for tendering for Ministry of Defence work will not be made available while the company remains in the public sector. This strategy is consistent with the policy being adopted for the remaining merchant shipbuilding yards in Great Britain. However, this is not consistent with the strategy being adopted in the case of the privatisation of, for example, Shorts, which can still tender for work pending a move out of the private sector.

In the case of the shipbuilding industry in Northern Ireland the Government has made it clear that it puts the ownership issue before orders. This may have the effect of making the yard less, rather than more, attractive to potential private sector buyers. It may also make it easier for Government, or the new owners if and when privatisation takes place, to close the yard : the lower the value of the order book the lower will be the capital costs of closure (to meet contractual obligations) and the lower the costs

of transferring the yard to private ownership (by reducing the level of work and potential losses which Government would have to undertake to underwrite).

Privatisation

This is the Government's clearly expressed preferred opinion, and two potential buyers are apparently in negotiation with Government. In seeking privatisation in this case the Government is obviously not seeking cash receipts as such but is seeking to reduce the future commitment of public funds to the industry.

Concern about the implications of privatisation centre on the employment implications. This is not surprising. Employment preservation was a primary motive for public ownership in the first place, and while public ownership has not prevented the loss of employment in Harland and Wolff it is undoubtedly ensured the preservation of employment at a level higher than would otherwise have obtained if strict market efficiency had been the goal.

Indeed, this strategy of preserving employment at a level higher than that supported by market forces may be efficient in a wider social sense. For example, if resources in an economy, in this case labour, are not in full use (as the present high levels of unemployment would suggest) workers made redundant on privatisation (market efficiency) will become unemployed or will displace other potential labour market entrants. In so doing they will contribute nothing to economic output. So called "second best" efficiency, or social efficiency, may therefore involve subsidising employment in both public and private ownership firms. However, Government has made it clear that it no longer accepts this argument and market efficiency concerns must dominate.

If a privatisation strategy is to be followed, any prospective new owner must meet at least the following conditions if some prospect of long-term viability is to be achieved and if the company is to survive to take advantage of the proposed upswing in demand in the early 1990s:

1. The new owner should have relevant experience and expertise of operating in this business.

2. The new owners should bring work and orders with them.

3. This new work should be in sectors of the shipping market which are either profitable without subsidy (ie prices cover all costs) or which are eligible for European intervention fund support, ie the company should continue its move upmarket into more sophisticated vessel types as the European Commission has made it clear that it will not support moves by European yards back into the oil/bulk carrier market and is therefore unlikely to authorise

all sectors are eligible but there is a ceiling

Not true!

intervention fund assistance for such orders.

4. The new owners can demonstrate the intention and capability of seeking orders for new work beyond those that they bring with them on take-over.

Management/Employee Buyout

This alternative way of taking the company back into the private sector has recently been floated. It is not yet possible to evaluate the proposal but it seems clear that its success will depend on the availability of firm orders and work to provide the basis for long-term viability.

As the only such firm contract apparently available currently is the Ultimate Dream concept, it may be useful to summarise some of the anticipated benefits and impact of that contract.

The estimated impact of the Ultimate Dream is based on the following assumptions:

1. The contract value is US$500m (approx £290m at current exchange rates).

2. The contract will extend over a four year build period, representing turnover/value of work of c.£70m annually.

3. Based on the recent experience of the company, around 70% of the value of the contract will go to outside suppliers of materials and services.

The estimated employment impact of Ultimate Dream (and these figures are only estimates) is as follows:

1. Direct employment in Harland and Wolff	2500-2750 jobs
2. Indirect employment in suppliers in Northern Ireland and Great Britain	2300-3100 jobs
3. Income multiplier impact in Northern Ireland	700 jobs

In other words up to 6500 jobs in total could depend on the Ultimate Dream contract, including those in Harland and Wolff itself. The overall employment impact may be rather higher (particularly in suppliers) as the employment content per £1m contract value is likely to be rather higher than for many other vessel types which the company could build (including the low technology tanker operations apparently underlying at least one of the private sector bids).

This employment will in turn have significant expenditure implication. On an annual basis net disposable income (after tax and other deductions) paid to the 6500 employees inside and outside the shipyard as follows:

1. Net wage and salary payments to Harland and Wolff employees £19m

2. Net wage and salary payments to employees in supplier firms in Northern Ireland and Great Britain £15m-£20m

This represents a major injection of spending power into the local economy and a significant additional injection of consumer spending in Great Britain, which will be highly localised in particular areas : around half of this represents disposable incomes paid to employees in areas of high unemployment in Scotland and in the North of England.

In addition there will be tax revenues generated for the national exchequer as a result of this contract. These can be estimated as follows:

1. Tax and national insurance revenues from Harland and Wolff employees £8.5m

2. Tax and national insurance revenues from employees in supplier firms in Northern Ireland and Great Britain £6.5m-£8.5m

In other words, the national exchequer will benefit to the sum of £15m-£17m annually in additional tax revenues over the duration of the Ultimate Dream contract. This figure should be set against the estimate that if full 28% intervention fund subsidy were to be paid for the contract, this would involve expenditure by Government of between £19m and £20m annually : most of the value of the subsidy is returned to the Exchequer in the form of additional tax revenues. Again, the importance of taking into account the employment, disposable income and tax revenue impact in Great Britain is emphasised. It is the wider implications of support for Harland and Wolff which are relevant to making a decision on future public support for the shipbuilding industry in Northern Ireland.

It should be noted at this point that in both the privatisation and the buyout cases the transfer of ownership to the private sector does not mean that Government will cease to be involved in the industry. In fact the opposite will be the case. Certainly Government will no longer have a direct input into the formulation and evaluation of company policy in the private sector (although it is interesting to note that although Government was instrumental in ensuring that Harland and Wolff moved upmarket in terms of the target product range agreed in the company's corporate strategy, it is apparently considering supporting a move back into the low price, low technology tanker/carrier end of the market as part of the privatisation process). However, Government will still play a central role as:

1. Provider of intervention fund subsidy on merchant ship-

building orders tendered for by a private sector owner.

2. Customer, through Ministry of Defence contracts, eligibility for which has enabled Harland and Wolff to survive the recent problems in the merchant shipbuilding sector.

In both cases the future prospects of a privatised Harland and Wolff, and therefore the prospects for continued employment, will depend crucially on the attitude of Government on a case by case basis to support the company in tendering for orders on terms which are as generous as those applying to other shipyards in the United Kingdom (for naval and quasi-naval work) and in Europe (for merchant shipbuilding orders).

Closure

If, however, neither the privatisation nor the buyout options are successful, continued public ownership is unlikely beyond the period of time necessary to complete work already in hand, although the Government has not made any firm statement of its intention in this situation.

In these circumstances closure becomes a possibility. If so, an assessment of the likely costs of closure should play an important role in the discussion.

Based on the figures quoted earlier for the overall economic impact of Harland and Wolff on employment and income generation in both Northern Ireland and the United Kingdom as a whole, the costs of closure can be estimated into two stages:

1. The capital (one off) costs of closure. These will include the cost of redundancy payments to direct Harland and Wolff employees (up to £40m) and to employees in supplier firms (perhaps a further £15m-£25m, depending on the redundancy schemes in operation in each company). They will also include the costs of contractual obligations and compensation payments if delivery schedules are not met during the run down process and the higher costs of completion that will result. These costs are likely to be significant, but in the absence of detailed information on the contractual conditions to be satisfied between the company and the ship owners it is not possible to quantify the sums involved.

2. The recurrent costs of closure, which represent the ongoing year to year costs in terms of lost tax revenues, reduced consumer spending power and higher social security costs arising from the resulting unemployment.

In the first year (assuming closure is not spread over a period of time) these recurrent costs of closure can be estimated using the following procedure:

The employment loss will be:

4000 jobs lost in Harland and Wolff directly

500 jobs lost in supplier firms in Northern Ireland

4000 jobs lost in supplier firms in Great Britain

8500 jobs lost nationally in total

The resulting income loss can be estimated as the difference between household disposable income from paid employment and social security benefits. The size of this loss of spending power will depend on the age and family characteristics of the workforce in both Harland and Wolff and supplier firms. Without specific information on these characteristics the following figures are at best only crude estimates (the calculation takes into account the estimate of DHSS in London that for over 60% of the long term unemployed social security benefits represent less than half their previous level of take home pay). On this basis the resulting loss of disposable income and spending power may be as much as:

1. £17.5m in Northern Ireland

2. £15.0m in Great Britain

£32.5m lost spending power nationally

The loss of this spending power is obviously important in the overall context of the Northern Ireland economy.

Furthermore, changes in expenditure patterns by individuals adjusting to lower income levels will be reflected in lower VAT receipts by Government.

Nationally this is lkely to result in a loss of £3m :

1. £1.5m lost VAT revenue in Northern Ireland

2. £1.4m lost VAT revenue in Great Britain

The major consequence of these employment and income losses will be reflected in:

1. Higher Government expenditure on social security benefits

2. Lower Government tax revenues which would have arisen from continued employment

Together these can be combined to estimate the net exchequer costs of unemployment to Government. Nationally it has been estimated that it will cost the Government around £7060 annually for each unemployed person in terms of higher social security benefits and lost tax revenues.

Using this figure and the estimates for lost employment arising from closure given above, the net exchequer costs of the resulting unemployment are as follows:

£28m (Harland and Wolff ex-employees)

£3.5m (ex-employees of supplier firms in United Kingdom)

£21m (ex-employees of supplier firms in Great Britain)

£52.5m TOTAL NET EXCHEQUER COST OF UNEMPLOYMENT NATIONALLY

There is also evidence to suggest that unemployment is related to worsening personal and family health, which will result in a higher consumption of health services and hence in higher public expenditure. A very crude estimate suggest that these costs may be:

£4.5m in Northern Ireland

£2.7m in Great Britain

Summary

To summarise, the overall impact of closure of Harland and Wolff is likely to be:

1. the loss of 8500 jobs nationally

2. the loss of £32.5m in net spending power nationally, which will have a knock on effect through the income multiplier

3. the loss of almost £3m in VAT revenues nationally

4. £52.5m net exchequer costs of unemployment nationally arising from lost tax revenues and higher social security payments

5. £7m higher health care costs

In total, therefore, complete closure of Harland and Wolff may lead to the loss of 8500 jobs and impose total costs on Government of £62.5m in lost tax revenues and higher public expenditure. This compares with a total subsidy to the shipyard of c.£59m in the present year.

Once the wider impact of the closure of Harland and Wolff on supplier firms in Northern Ireland and, in particular, in Great Britain is taken into account the recurrent costs of closure appear considerable:

(a) Recurrent costs (based on first year after closure) £62.5m

(b) Capital costs - redundancy (up to £40m in Harland and Wolff, up to £25m in suppliers) £65m

(c) Capital costs - contractual obligations and completion delays/cost overruns — Unknown

However, these recurrent costs of closure do not make allowance for redeployment of labour within the labour market. One outcome of closure would be the creation of a core of long-term unemployment and displacement of other would-be entrants to the labour market. However, some adjustment to the above cost estimates would have to be made to allow for re-employment, particularly among employees of supplier firms. The Treasury, for example, work on the assumption that after 5 years there will be no remaining discernible effect of a major redundancy on the labour market. Using this assumption, the net exchequer costs of the closure of Harland and Wolff over a five year period would be approximately £200m.

Taking into account the capital costs of closure (excluding the cost of buying out contractual obligations and the possible cost of losses on work on hand), this represents a minimum cost of closure of £265m over five years. On the assumption that a continuing business would employ 2500-2750 (as in the estimate for the Ultimate Dream contract) this is equivalent to continued subsidy of up to £20,000 per job year.

In other words, over a five year period the subsidy to Harland and Wolff would have to exceed £20,000 per employee per year to make closure a more cost effective option than continued public sector support. With industry analysts predicting a significant upturn in the market by the early 1990s, survival for the next five years may be sufficient to provide the base for productive employment in the shipbuilding industry in Belfast for some time to come. Public sector financial support for that survival process may not only be necessary but, in economic terms, efficient relative to the costs of closure.

OCTOBER 1988

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DEPARTMENT OF ECONOMIC DEVELOPMENT

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D J Ritchie Esq
Department of Finance and Personnel
Parliament Buildings
Stormont
BELFAST
BT4 3SW

Your reference

Our reference

Date 30 December 1988

Dear Denis

HARLAND & WOLFF: CLOSURE COSTS

I attach (Annex A) a revised version of our earlier illustrative table of Harland & Wolff closure costs which provides a figure of over £252m (as compared to the earlier £202m in a previous table which you have seen).

As we have discussed, we need to take into account other costs which will be incurred if the Company closes. You will see that our Economists have worked out a figure of £52m for additional Social Security payments (see table attached to Annex B). There will also be the need for remedial measures which were mentioned in the last E(A) paper at a cost of some £90-95m.

You will understand that the Company's figures on which Annex A is based are already somewhat dated and we will need to approach Harland & Wolff for a more up to date forecast of trading costs. We would appreciate the opportunity of discussing the figures with you early in the new year.

S.J. Wilson

p.p. IVOR C GREER

cc Mr Fell
Mr Gibson
Mr McDonnell

(without attachments)

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ANNEX B

HR Green updated by R Scott - (23/11/78)

ag 1/12.

H&W REDUNDANCIES

1. This note is concerned with two issues:

   (a) What is likely to be the net effect of the hypothetical redundancies on the number of people unemployed?

   (b) What would be the direct implications for public expenditure in Northern Ireland.

2. The net effect on unemployment would depend on three considerations:

   (a) the number of direct redundancies;

   (b) the number of consequential redundancies arising from

      (i) loss of jobs in local sub-contracting and supplying firms, and

      (ii) loss of jobs in local firms resulting from reduced expenditure on consumption;

   (c) the period of time that the labour market will take to adjust to the shock of redundancies.

3. (a) The number and timing of direct redundancies is set out in the first row of the accompanying Table.

(bi) Past work on employment in related forms suggests a figure of around 400-500. Not all of these jobs are dependent on H&W in the sense that they would necessarily go in the event of closure.

(bii) The effect on jobs generated by H&W employees' expenditure on consumption would depend on the reduction in that expenditure in the event of closure. The fall in wage income would be partially offset by social security benefits. The replacement ratio - ie the ratio of average benefits to average earnings - appears to be around 67 per cent. Moreover the fall in wage income would initially be offset by the receipt of redundancy payments. Average redundancy payments per head would be around £20,000.

4. I suggest that around 750 jobs would be a reasonably generous allowance for indirect employment under both (bi) and (bii). This would be equivalent to using an overall employment multiplier of 1.2.

5. Current Treasury and DTI practice in assessing the response of the labour market to short-period shocks is to assume that unemployment will very rapidly return to its trend level. For severe shocks in problem areas they are prepared to allow a five year adjustment period. In past assessments, when we wanted to bolster a case for assistance, we have argued that the adjustment process would take longer in Northern Ireland, and we have, on occasions, used a ten year adjustment period. Treasury has shown no great willingness to accept this argument. Moreover we have become increasingly convinced that local labour market adjustment to shocks is, in fact, fairly rapid. In a hard-nosed assessment of the effect of redundancies a five year adjustment profile is not inappropriate.

6. In the Table it is assumed that registered unemployment increases by the full amount of the job losses as they occur, that 5 per cent of that total disappears from the register after one year, 10 per cent after two years, 30 per cent after three years, 70 per cent after four years and 100 per cent after five years.

7. The movement of people out of unemployment occurs because

   (a) additional jobs are created as a consequence of the freeing of resources after closure,

   (b) people move out of the labour force eg through early retirement,

   (c) workers move out of Northern Ireland.

   Automatic additions to employment under (a) are likely to be small. Even if unemployment returns to its pre-shock level after five years employment is likely, on this account, to be substantially lower. The main avenue of unemployment adjustment would be through increased emigration.

8. In the public expenditure estimates it has been assumed that all redundancy payments have to be met from public funds. ERDF assistance towards these costs may be available under the terms of the Renaval programme.

9. In the absence of information on the age and family circumstances of the H&W workforce we have assumed that half are single men and half are married with one child. Average social security payments have been rounded to £3,750 per annum.

November 1988

EFFECTS OF REDUNDANCIES ON REGISTERED UNEMPLOYMENT AND PUBLIC EXPENDITURE IN NORTHERN IRELAND

Year to March	1988	1989	1990	1991	1992	1993	1994	1995	1996	1997	TOTAL
Direct redundancies		380	1323	568	1429	-	-	-	-		3,700
Indirect redundancies [1] (NI only)		76	264	114	286						740
Net effect on registered unemployment [3] (deviations from 1987)			1219	2242	3189	3368	2292	1182	386	0	
Redundancy payments £ millions		11.0	23.3	17.4	13.6	24.7					90.0
Social Security payments [2] £ millions			4.6	8.4	12.0	12.6	8.6	14.4 4.4	1.4	0	52.0
Effects on public expenditure in Northern Ireland £ millions		11.0	27.9	25.8	25.6	37.3	8.6	4.4	1.4	0	142.0

1 These estimates refer to related job losses in Northern Ireland only.
2 Excludes net reductions in tax flows to the Exchequer.
3 Approximate average for the year.

Assumptions: Financial forecasts to March 1993 (as at June 1988) but assume closure in March 1992 and 200 steelworkers go by March 1991.

DEPARTMENT OF ECONOMIC DEVELOPMENT

H&W CLOSURE COSTS REVIEW

February 1989

3. SUMMARY

In our view, the assessments of cost to closure made by H&W are towards the optimistic. We believe that actual costs will be higher than the figures put forward by the company.

We will prove (note!?) the points raised inn this preliminary document and report back to the Department as soon as possible.