Mr Walters
Mr Duguid

PRIME MINISTER

BRITISH STEEL CORPORATION: CORPORATE PLAN

At E Committee on 3 February (E(81)5th) I was asked to circulate to colleagues a note which set out in more detail the purposes for which BSC needed external finance in 1980/81 and 1981/82.

... 2 I attach at Annex A a table giving a breakdown into its main components of BSC's estimated external finance requirements of £1121m for 1980/81 and £730m for 1981/82. The main outflows are funding of a trading loss (after depreciation and before interest) of £480m in 1980/81 and £225m in 1981/82 (this includes provision of £50 million for the 7% pay award from July 1981); provisions for redundancies and closure costs of £350m in 1980/81 and £183m in 1981/82, most of which is likely to be committed by July; and net capital expenditure of £167m in 1980/81 and £198m in 1981/82 (about half of which will be covered by depreciation). The capital expenditure provision for 1981/82 contains no significant sums for major new projects, and the Chairman has agreed to consult me before authorising work on the two new projects he has in mind; no irrevocable commitments will be made before July. Interest payments will fall from £179m to £93m, mainly as a result of the proposed capital reconstruction.

No

3 The extra £150 m in 1980/81 is needed primarily to fund current losses and redundancy payments. It is in fact £50 million lower than the sum which, last September, BSC expected to need to finance

/their ...

their operations until the end of the 1980/81 financial year.

4 I was also asked whether the deferred wage increase of 7 per cent from 1 July could be accommodated within a lower EFL and financial target for 1981/82. I discussed this, and the possibility of setting tighter financial targets, with Mr MacGregor before circulating E(81)13, and he made it clear that he did not regard further tightening as realistic. I do not think that I will be able to persuade him otherwise (he is at present in North America). As colleagues noted during our discussion in E Committee on 3 February, the attainment of the targets for 1981/82 is critically dependent on external circumstances beyond the control of BSC. There are some contingency allowances in the Plan which in principle could be used to cover the £50 million required for the pay settlement. However, this would leave an unrealistically low level of contingencies for external factors such as the DM exchange rate, which is already at a level which is more damaging to BSC's prospects that it was at the time the Corporate Plan was drawn up.

He would have to if he were in Japan.

... 5 You will also see from the revised draft statement (attached) that in the light of E(81)5th I no longer propose to say that, if Mr MacGregor proposes further closures, the Government will not intervene in that decision. I regret this omission. The underlying thought behind E(81)11 was that we should aim for the largest British steel industry that is profitable; but that it is more important that manufacturing industry as a whole should

?

/have ...

have access to steel that is competitive (in price, quality, delivery and so on), wherever it may come from, than that the steel should be made here. As I emphasised in the E Committee discussion, I believe that any significant departure from this could be very expensive. More positively, the profit criterion is much the best indicator of success in what I regard as our main objectives for BSC: to get the Corporation back to normal commercial viability (and so to open the way to further privatisation) in what is a highly competitive commercial environment; to ensure that the wider manufacturing industry of this country does not incur a competitive disadvantage; and to ensure that existing private sector capacity is not driven out of existence by the long-term maintenance of uneconomic BSC facilities. Colleagues should understand that some steel converting parts of BSC could be and would be sold to the private sector if they were not needed in BSC as outlets for steel made in plants that are at present unprofitable. To depart from the profit criterion will lead to a larger and costlier nationalised industry than otherwise. Perhaps less importantly, but still significantly, the policy I prefer is central to our obtaining acceptance for our continued financing of BSC from the EC Commission under the Decision on State Aids for Steel, which we are committed to support; and the profit criterion is reflected in Mr MacGregor's terms of reference and the basis on which compensation is to be paid to Lazards for his services. I am prepared, if colleagues insist, to try to work out wider criteria against which to judge proposals for closure, but I am nervous of the consequences and would much prefer to stick to the use of a commercial yardstick and deal separately with the social effects.

!!

6 I should draw colleagues' attention to para 14 of the draft statement. In E(81)13 I suggested that we approve officials' recommendations that BSC be asked to consider creating Companies Act companies for some of their activities. I think it would be wise to mention this in the statement since I am receiving increasing evidence of disquiet from the private sector at the new vigour with which BSC is competing with them and of the likelihood that they may be doing so with the help of taxpayers' money. The formation of Companies Act companies would help to bring a greater degree of transparency to BSC's operations. Transfer prices between BSC and their Companies Acts subsidiaries will be a crucial issue and I propose to discuss the matter with Mr MacGregor.

Exactly and a 7% = increase in pay

7 I invite colleagues to agree that I should now make a statement to Parliament on 11 February on the lines set out in the attached draft, which takes into account the points raised in our discussion including a reference to redundancy pay which Mr MacGregor has welcomed in principle. My statement will also introduce the one clause Bill to raise BSC's borrowing limit and the longer Bill to remove the Corporation's duty to supply and to effect the capital reconstruction which we discussed in Cabinet on 5 February. Arrangements are being made for the borrowing powers bill to complete all its Commons stages in the week beginning 16 February and to obtain Royal Assent by the end of the month. The Second Reading will in effect be a debate on the Corporate Plan and my statement.

/8 ...

8 I am copying this to our colleagues on E, to Francis Pym, George Younger, Nicholas Edwards and Michael Jopling and to Sir Robert Armstrong.

KJ

K J

Department of Industry
Ashdown House
123 Victoria Street

6 February 1981

ANNEX A

BSC Estimates of Cash Requirements 1980/81 and 1981/82

B

	Cash inflow/(outflow)	
	1980/81	1981/82
	£M	£M
Trading Profit/(loss) before interest and after depreciation	(480)	(225)
Interest	(179)	(93)
Redundancies/ closure costs	(350)	(183)
Working capital and stocks	(75)	(149)
Capital expenditure (net of RDG)	(167)	(198)
Depreciation	95	100
Disposals	35	54
Contingencies	-	(35)
	(1121)	(729)

Only £350?

£730

Notes (1) The reduced interest payments in 1981/82 mainly reflect the capital reconstruction envisaged

(2) The total working capital requirement for 1980/81 was low, partly because of distortions resulting from the end of the strike, and partly because of the major contraction in output during the year. The larger figure for 1981/2 reflects the volume increase envisaged by BSC.

M

This statement as drafted will bring maximum harm to the Govt. We want the briefest possible statement leaving in mind the whole thing to be reviewed in 6 months time with the viewing [?] possibility of the privatisation [?].

DRAFT STATEMENT ON BSC CORPORATE PLAN

With permission I will make a statement about the British Steel Corporation.

2 I am making available in the Library of the House and in the Vote Office a report by BSC giving background on its performance and current plans.

~~3 The past 12 months have been extraordinarily difficult for the steel industry of this country - both the public sector and the private - and indeed for steel industries throughout Europe. There has been a considerable surplus of capacity; prices have been extremely low and most major European steel companies are losing money. Hence the declaration by the European Commission of a "manifest crisis" and the unanimous agreement of the Community Governments to mandatory production quotas.~~

~~4 The British Steel Corporation have nonetheless taken substantial steps to adjust to the changed environment. The Corporation undertook a massive retrenchment programme~~ in the course of 1980 ~~cutting~~ manned steelmaking capacity was cut from 21½ million to 15m tonnes of liquid steel ~~to 15 million~~. A number of works were closed and manning levels slimmed down at others in order to bring productivity at them up towards international standards. In 1980 there were 50,000 job losses at BSC. ~~This has taken place at the same time as the Corporation was recovering from the considerable~~

damage caused by the strike. We must all be impressed by the co-operative and realistic attitude of the workforce in recent months in accepting these necessary changes and by the vigour with which the Corporation's management has approached its task.

5 I appointed Mr MacGregor in July to be Chairman of the BSC, with a remit to return it to enduring profitability. Mr MacGregor's strategy is to intensify the Corporation's drive to cut the costs of production, which had become significantly higher than those of the Corporation's main competitors, and by vigorous marketing to increase the volume of sales so that BSC can compete more effectively in European and world markets. To this end Mr MacGregor has reorganised the BSC into a number of separate businesses, each responsible for the production and marketing of a specific product range under a decentralised and profit conscious management team. Towards the end of the year, BSC had come close to regaining its pre-strike share of the UK market.

6 The Corporate Plan which Mr MacGregor submitted to the Government shortly before Christmas embodies and continues this approach. It provides for a manned capacity of 14.4 million tonnes of liquid steel a year - a slight reduction from the existing capacity of 15.2 million tonnes; and it envisages that by the end of 1981/2 the rate of loss will have been substantially reduced from its present level, estimated for 1980/1 at about £480 million. To achieve this the Corporation intends to press ahead with its

cost reduction and marketing programmes, so that by the summer it will have a clear view of whether the objectives of the Plan can be met. Mr MacGregor has made it quite clear to the Government and to all members of the Corporation, both managers and work-force, that there will be no future for any operations that are not competitive.

7 To further his plan Mr MacGregor has asked the Government to provide an extra £150 million in 1980/1 [to bring the total external finance requirement to £1,121 million] and for £730 million in 1981/2.

8 The Plan, and in particular the proposed level of output, is highly sensitive to external economic circumstances such as the level of the Deutschmark, the state of the European market and the timing of the upturn in steel ordering in the UK. Mr MacGregor ~~himself freely admits, indeed claims, that his Plan is optimistic and in the light of these risks I think he is right.~~ He aims for the largest operation that can be made profitable; but at the same time he is committed, if the assumptions behind his Plan are not sustained, to reduce the Corporation to a size that is profitable. ~~He is aiming for the best whilst being prepared for the worst.~~

9 The Government are prepared [~~to approve the Corporate Plan and~~] to provide the finance needed to implement it. the Plan. We are setting the Corporation the target of limiting their loss before interest in

1981/82 to £225 million, in accordance with the Plan, and in comparison with the estimate of £480 million for 1980/81. ~~We are also asking the Corporation to plan ahead on the basis that they should aim to achieve breakeven, also before interest, in 1982/3.~~ We shall increase the External Finance Limit for 1980/81 ~~to £1121 million~~ by £150 m. We have also agreed that the EFL for 1981/82 should be £730 million. This is a high figure, reflecting in part the substantial though reduced losses, but also including a programme

?

of essential capital expenditure and continued heavy redundancy and closure costs. We have been prepared to provide funds to BSC for the generous level of severance payments which they have negotiated over the last two years, ~~Despite the fact that no private sector company in BSC's position could afford such payments, we are prepared to do so again for 1981/82,~~ in recognition of the urgent need to eliminate surplus capacity and overmanning. But I do not think it reasonable for the Corporation's employees to expect that the Government will be willing to ask the taxpayer automatically to continue to finance redundancy payments on this scale - which will cost about £350 million in 1980/81 and about half that in 1981/82 - beyond the end of 1981, should substantial further closures or redundancies prove necessary.

10 If ~~I must also emphasise that, as I have already explained~~, Mr MacGregor's plan is too optimistic ~~optimism may not be justified and~~ his commercial judgement may then lead BSC to seek further closures or redundancies in order to achieve the financial objectives they have been asked to meet. The Government will monitor events closely and we have asked Mr MacGregor to let us have his assessment

of progress in July.

11 In addition, I have published today two Bills, the Iron and Steel (Borrowing Powers) Bill 1981 and the Iron and Steel Bill 1981. I shall be asking the House to pass the first Bill to raise the borrowing powers quickly, since the Corporation will reach its current statutory borrowing limit at the end of February. The second Bill will write off some £3,500 million of BSC's capital immediately, provide a power to write off a further £1,000 million later and make certain consequential adjustments to the Corporation's borrowing limit. These write-offs will deal with the mistakes of (over-investment - ?) the past. They do not represent the commitment of additional funds. The second Bill will also amend the Iron and Steel Act 1975 to allow the transfer of businesses to the private sector and to permit a rapid and, indeed, extensive run-down of the Corporation if that proves necessary.

12 The Government are aware that implementation of BSC's plans will result in substantial job losses in a number of areas which have unemployment above the national average. As they are all Assisted Areas considerable support is already available to encourage new investment and to help those made redundant to find new jobs, though I do not in any way underestimate the problems for the communities and people concerned. I shall, if necessary, consider whether any further measures of assistance would be appropriate.

13 The private sector in this country has also faced severe difficulties. This has caused particular concern in those areas

where BSC's operations overlap those of private sector companies. It is neither just nor sensible that the Government should subsidise State-owned activities which have the effect of driving independently owned companies out of business. The Government, therefore, authorised the Corporation in the autumn to open negotiations with those private sector companies who were interested and whose operations overlapped their own with a view to seeing whether viable joint companies could be created. Two such companies are under discussion. The Government will continue to give every encouragement to these negotiations so long as they are on a commercial basis and result in operations which are commercially viable; and as I have already indicated, the Bill will contain provisions to facilitate these and other transfers to the private sector.

14 There will nevertheless remain substantial areas in which BSC will continue in competition with the private sector, particularly in steel-related businesses such as stockholding and construction as well as some sectors of steel production. I have made it clear to Mr MacGregor that he should, as far as possible, ensure that the businesses concerned compete fairly with the private sector and that they do not use taxpayers' money to lower prices solely in order to take business from private sector competitors. In order to ensure that such competition is seen to be on a fair basis, I have asked Mr MacGregor to consider setting up separate Companies Act companies for these businesses where they do not already have that form.

15 We shall also do what we can within the European Community to ensure that market conditions in Europe are improved. The House will remember that during the autumn the Council of Ministers agreed that a state of "manifest crisis" existed in the steel industry and that production quotas were imposed under Article 58 of the Treaty of Paris. These quotas expire at the end of June and we are already in discussion within the Community on the regime that will replace them. It is our intention to seek to ensure that any reductions in capacity which are necessary are equitably shared among the members of the Community and that, so far as possible, short term market conditions do not invalidate long term commercial objectives.

16 The financial provision we propose will require approval from the European Commission.

17 I am sure that the House will wish the Corporation, its work-force and its managers success in the difficult task they face.