Ref: A0928

PRIME MINISTER

BRITISH STEEL CORPORATION

To be raised orally at E on 12 December

BACKGROUND

The basic issue is whether to accept the implications of low steel demand and tight cash limits for the British Steel Corporation (BSC). These now imply both substantial plant closures and fairly small pay increases, because of deteriorating circumstances since the cash limit was fixed in June.

2. As described in Sir Keith Joseph's minutes of 28 November and 11 December, the main components of the deterioration are:-

a. BSC will fail by a long way to meet their target of break-even by March 1980: they now expect losses for the second half of 1979/80 to be even worse than the £150 million loss in the first half.

b. Instead of a profit in 1980/81, BSC expect a loss of at least £76 million with "downside risks of £200 million or more."

3. BSC's main proposed responses are:-

i. Closure or "mothballing" of one quarter of BSC's effective capacity, half of it in South Wales and half in the North East, leading to perhaps 30,000 fewer jobs in 1980/81 (in addition to those already planned to go at Shotton and Corby).

ii. A 2 per cent (plus productivity) pay offer.

4. The Secretary of State for Wales feels that the case for BSC's proposals is not made out. His main grounds for complaint are:-

a. The Government does not have enough information about the assumptions behind BSC's proposals to be assured of their validity;

b. We cannot just leave it to the management because their competence is open to question.

5. You agreed that the issue should be discussed at E this week because of the Supply Day debate on steel on Thursday.

HANDLING

6. You might ask Sir Keith Joseph to introduce the subject and then call Mr Edwards as he has requested the discussion. You might suggest that some of the key issues are:-

a. How far should we question BSC's judgment? Should they have given us more information? When the cash limit was set in June (this is the one Sir Keith Joseph thinks BSC should continue to work within), the Department of Industry and Treasury did not have a great deal of information about the assumptions (eg market share forecasts) underlying BSC's proposals. This contrasted with the position in earlier years when BSC had submitted regularly a 5-year corporate plan (and it contrasts with eg British Leyland now). Even now we do not have much detailed information on BSC's assumptions for their new closure proposals. The arguments against having this information were twofold:-

i. So as not to "second-guess" the BSC management;

ii. Because unlike (say) BL, BSC were not proposing significant new investment which needed industrial appraisal.

Do colleagues feel these are satisfactory distinctions? Or should the Government reach its own view on steel demand as the Welsh Secretary suggests? The trouble with this approach - apart from the general undesirability of second-guessing management - is that on the whole the Government's forecasts are mostly even more pessimistic than BSC's. (See, for example, the latest information on import penetration and the falling demand from the motor industry, for which you asked, set out in the Department of Industry letter of 11 December.) An independent assessment of BSC's assumptions might therefore put more pressure on them to close more capacity than they are proposing? Do colleagues want this - with the implied responsibility for closures - or are BSC going ahead with closures as fast as is realistic?

b. Are we justified in sticking to the cash limit in view of the deterioration in BSC's performance. There are two fundamental difficulties in altering the cash limits to make them more generous. The first is the impact on the credibility of the cash limit system (though circumstances in steel are exceptional). The second is the reduced pressure which would be exerted on BSC to achieve closures or otherwise put their house in order.

c. Offsetting Measures. The Welsh Secretary argues that the Government cannot risk the economic and social disruption which the BSC's plans involve. But if the Government stands firm on cash limits, there is very little else which it can do to help. One possibility (which you asked should be considered) is the limitation of imports - at least by the public sector (steel rails from Luxembourg). The scope for doing much here, within the Treaty of Paris, is very limited. Another is to secure trade union support for improved productivity. Despite problems like the ban on coking coal imports, BSC and the unions are probably doing as much as is feasible in the short term - ie this financial year and next. That leaves only remedial measures to offset (not avoid) closures. Mr Edwards has little money left for further advance factories, roads, etc to bring new work to run-down steel communities. Nor - in the present public expenditure climate - is there much prospect of further funds being made available. But he will at least want to argue the case.

d. Pay and Strike Action. You have already indicated support for BSC's sticking to their firm line. You might ask what the likely results are going to be. Will the steelworkers cave in - fearing for their redundancy payments? And can the economy stand a prolonged strike as most people instinctively think? Sir Keith Joseph's latest minute says that vehicle manufacturers' steel stocks are low; this suggests BL for one may be badly hit. In short, do we need room for manoeuvre on the pay front or is this the example which drives the message home?

e. <u>BSC Management Changes</u>. You might ask the Secretaries of State for Industry and Wales to substantiate any doubts about present BSC management. Do they have any possible suggestions?

CONCLUSIONS

7. You may wish to record conclusions on:

a. whether to maintain the requirement to break even on 1980/81 (as Sir Keith Joseph proposes) or to allow some easement;

b. whether to stand firm on pay;

c. any suggestions about the management;

d. any further measures to reduce the need for closures or ameliorate their effect on local communities.

MAP
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ROBERT ARMSTRONG

11 December 1979