

*Prime Minister*

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*to the Prime Minister*



*To per glance.*

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20 March 1980

*[Handwritten signature]*

PRIME MINISTER

Adam Butler sent you a note on the possible longer term industrial effects of the steel strike on 15 February. His note included some estimates of the macro-economic effects by his economists. I thought that you and our colleagues most concerned with the strike would be interested to see a rather fuller assessment of the macro-economic effects of a 3-month strike which Treasury economists have made.

2. I must stress that these estimates are subject to great uncertainty. Although the Business Statistics Office, the CBI and the Department of Industry's own contacts with industry are providing us with valuable clues to the industrial effects of the dispute, we have as yet very little official economic data for the period from 1 January and so it is difficult to make confident predictions about the industrial, let alone the wider economic, effects of a 3-month strike.

3. Subject to these important qualifications, the assessment suggests that a 3-month strike could reduce GDP by almost  $\frac{1}{3}\%$  in 1980, worsen the current balance by £400m and increase the PSBR by about £325m in calendar 1980.

*[Handwritten scribble]*

*this will actually impact mainly on 1980/81 because of lags in bill payments and tax payments.*



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1980. The monetary effects seem likely to be small - there will probably be some increase in  $\text{\pounds}M3$  in the first half of 1980 which may be partially reversed later in the year.

4. I am sending copies of this minute to members of E Committee, George Younger, Nicholas Edwards and Sir Robert Armstrong.

A handwritten signature in dark ink, appearing to be "G.H.", written in a cursive style.

(G.H.)



## MACRO-ECONOMIC EFFECTS OF THE STEEL STRIKE

This note provides an assessment of the short-term macro-economic effects of a strike at BSC lasting for 3 months. It inevitably involves a number of fairly arbitrary assumptions about the effects of the strike. The available evidence on the impact of the strike so far has been taken into account in making the assessment. Nevertheless major uncertainties remain especially about the size and timing of the impact on steel-using industries and about the extent of the recovery after the strike.

Summary of Major Effects

2. A 3 month strike could reduce GDP by almost  $\frac{1}{3}\%$  in 1980 - the impact being greatest in manufacturing where output could fall by  $\frac{2}{3}\%$ ; it could worsen the current balance by £400m; and it could increase the PSBR by about £325m in calendar 1980. The effect on output will be concentrated in the first quarter of 1980 when GDP might fall by nearly 2%. There should then be some recovery later in the year. However, the adverse effects on the PSBR and the balance of payments are likely to be felt almost entirely in the second and third quarters of 1980.

Effects on the steel industry

3. Including the impact on private steel manufacturers, the steel industry will probably lose over half of its output during the 3 months of the strike - equivalent to about  $\frac{1}{4}\%$  of GDP - and a certain amount more in the month or so it takes to restore full production. It has been assumed that one-third of this lost output will be recovered during 1980 and that the remainder is a once-for-all loss which is replaced by additional imports of steel.

4. No allowance has been made in this assessment for any permanent loss in BSC's market share as a result of the strike. Some continuation of the past loss in share would have been likely in any case. The strike will probably at least bring forward the timing of this loss although the size of this effect is very difficult to assess.

5. The strike will cut BSC's gross trading surplus by well over £100m in the first quarter of 1980, some of which should be recovered as output is increased later in the year. However, it seems likely



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that BSC's cash position will actually improve in the first quarter. BSC grants a large amount of trade credit and, provided customers continue paying bills, revenue should still flow in during the strike at a time when outgoings, especially on labour costs, will be reduced. The adverse effect on cash flow will probably be felt primarily in the second quarter.

6. About 150,000 BSC workers are on strike or laid off. There are also some lay-offs in the private sector.

Effects on other industries

7. These are particularly difficult to assess and have been the source of considerable error in previous disputes.

8. It has taken longer for the output of steel-using industries to be affected than seemed likely when the strike began. The evidence of, for example, the Business Statistics Office surveys suggests that the impact on manufacturing increased in February but still remained fairly limited. A further increase is likely in March but there is no indication that there would be a major worsening of the situation if the strike were settled by the end of the month. It has been assumed for this assessment that steel shortages outside the steel industry will reduce GDP by about  $\frac{1}{2}\%$  in the first quarter of 1980. This is equivalent to an output loss of about 2% in the steel-using industries (Industrial Orders 7-12) in February - broadly the size of effect suggested by the Business Statistics Office Surveys - and a loss of 3% in March. Most of the loss can probably be met out of stocks but there could also be some effect on imports and exports and on other elements of domestic demand, such as investment. It has been assumed that, after the strike, over 80% of this loss is recovered through additional production.

9. The decline in production and movement of steel will also reduce the demand for domestically produced inputs into steel such as transport, electricity, and refractory materials. It has been assumed that most of this - equivalent to about  $\frac{1}{2}\%$  of GDP - will be reflected in lower production in the first quarter and that the remaining output will be split between a small temporary rise in stocks and import replacement. Later in the year, demand and output will recover somewhat in line with the extra production in the steel industry and the rebuilding of steel stock levels.

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10. On top of these direct effects, there will also be effects on output resulting from reductions in consumption and possibly investment in response to lower disposable incomes and output as a consequence of the strike. These second-round effects seem likely to be small.

11. Lower production will produce short-time working and lay-offs outside the steel industry. These have been fairly small so far but are likely to increase<sup>as</sup> the strike continues.

Effects on the balance of payment

12. The current balance is unlikely to be much affected in the first quarter of 1980. There could be some deterioration in the steel balance if steel imports continue to hold up and in the balance in those metal products whose output is affected by the strike. However, this should at least be offset by lower imports of inputs into production as a result of lower domestic output. Subsequently, there is likely to be a significant worsening in the current balance as steel-users turn to imports to make good their stocks of steel after the end of the strike. The net effect could be a worsening in the current balance of around £400m for the year as a whole.

Effects on the PSBR and the money supply

13. The underlying financial position of the public sector is likely to worsen by about £450m in the first quarter of 1980 as a result of the strike, of which around £200m represents lower tax accruals and higher benefit payments resulting from lower economic activity and the remainder is mostly lower trading surpluses of BSC and other public corporations. After the strike, there should be an improvement of over £100m in 1980/81 as the recovery in output raises tax revenue and public corporation surpluses.

14. However, the adverse effect on the public sector's actual cash position and hence on the PSBR will be mainly felt in the financial year 1980/81 because of the assumed effect of bill payment lags on BSC's cash flow as well as lags in the payment of taxes. In fact it seems possible that the PSBR will <sup>not</sup> rise at all in the first quarter of 1980 but will increase by about £325m in the financial year 1980/81, most of which will be concentrated in the second quarter of 1980.

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15. In the first quarter of 1980, the counterpart to the higher underlying PSBR and to a likely lower personal sector surplus - as striking and laid-off workers draw on their savings to partially maintain their expenditure - will be an improved company sector financial position as steel stocks fall and some workers are laid off. Some of this cash will be used to pay off trade credit extended by BSC. Later in the year these effects will be reversed as companies' positions deteriorate when they build up stocks again.

16. The monetary effects of these changes are uncertain but seem likely to be small. They will probably involve some increase in £M3 in the first half of 1980 which will perhaps be partially reversed later in the year.

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