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PS/*Secretary of State for Industry*

1 April 1980

Tim Lankester Esq
Private Secretary to the
Prime Minister
10 Downing Street
London SW1

Dear Tim

BL

As background for the Prime Minister's meeting on Wednesday my Secretary of State has asked me to let you have the attached letter of the 28 March from Sir Michael Edwardes following last week's meeting of the BL Board; and a note by Department of Industry following discussions with Treasury and the Department of Employment on possible regional measures.

I am copying these also to Martin Hall (Treasury), Richard Dykes (Department of Employment), Gerry Spence (CPRS), David Wright (Cabinet Office) as well as John Hoskyns.

Yours sincerely

Catherine Bell

CATHERINE BELL
Private Secretary

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FROM SIR MICHAEL EDWARDES

28 March 1980

The Rt Hon Sir Keith Joseph, Bt, MP,
Secretary of State for Industry
Ashdown House
123 Victoria Street
London SW1E 6RB

Mr Hagestadt
FOR ADVICE (AND DRAFT REPLY IF APPROPRIATE)
PLEASE BY: 1.4.80

COPIES TO
PS/MB
PS/MM
Sec
Mr Lippitt
Mr Bullix
Mr Bell
Mr Leeman

Dear Secretary of State,

As envisaged in my letter to you of 18 March, I am writing to confirm our assessment of our cash position following our Board meeting on 26 March. The Board reviewed the Company's performance thus far in 1980 and the outlook for the rest of the year. I am pleased to advise you that the sales campaign which we launched in January has started to show results in March. With market share running well over 20% so far this month, we expect cash to be on budget for the first quarter.

Our objectives for the year remain the same - to protect the programmes which are fundamental to the future viability of the business, and to ensure that we do not exceed the agreed cash call on Government during its 1980/81 financial year. You will recall that our 1980 budget took account of an anticipated £50m deterioration against the starting point assumed for the 1980 Corporate Plan. In the event, the engineering strike made an even deeper impact on our cash flow for 1979 and we started the year some £70m worse than the Corporate Plan base.

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The Rt Hon Sir Keith Joseph, Bt, MP 28 March 1980

Nevertheless the Company forecasts a cash flow outcome for 1980 which is within the total agreed cash call on Government. This forecast reflects the review of capital expenditure, the acceleration of the restructuring and redundancy elements of the recovery programme and the vigorous marketing and other actions. We have provided your officials with the details of this forecast, which as I indicated to you in my letter of 18 March, assumes an early end to the Steel Strike,* and that the unilateral implementation of our pay and working practice proposals for Cars is accomplished without major disruption.

The Board reconsidered this forecast at yesterday's meeting and concluded that, while the Company remains susceptible to unforeseen problems eroding the narrow margins we have, there is no evidence to date which would suggest that we cannot meet our objective of staying within the agreed cash call on Government during its 1980/81 financial year.

So far as 1981 onwards is concerned, the Board will review the outcome when, as we discussed in our recent meeting, we have agreed with your officials the economic assumptions which we should use for the post 1980 years. The cash outlook over the remaining years of the Plan will be heavily dependent on the base economic assumptions which are used.

I am copying this letter to Sir Arthur Knight.

Yours sincerely,
Michael Edwardes.

* i.e. over Easter weekend.

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MEASURES WHICH MIGHT BE TAKEN IN RESPONSE TO A
PARTIAL COLLAPSE OF BL

I. Background and assumptions

1.1 At the end of 1979 British Leyland employed about 144,000 people of whom some 50% were located in the West Midlands, 16% in the North and North West of England and Scotland (Leyland Vehicles - LVL) and 14% in Oxford and Swindon. Best estimates suggest a one to one relationship between BL employment and dependent employment giving a total of some 290,000 jobs at risk; but the total could be greater if, as is possible, the loss of BL business has a disproportionate effect on the viability of suppliers. Some 45% - 50% of BL supplier employment is also located in the West Midlands.

1.2 It is by no means clear what will happen to BL. Although a total collapse remains possible, it is perhaps more likely that parts of BL could be saved and for the purposes of this paper we have taken the optimistic assumption namely that Leyland Vehicles, Land Rover, Jaguar and some ancillary activities could remain to give a total BL job loss of 79,000 and an "all-up" job loss of some 160,000. More than half the BL job losses would occur in the West Midlands and 20% in the Oxford area.

1.3 These assumptions and this paper only deal with the first stage effects of a BL collapse. The ripples are bound to spread more widely both as a direct consequence of the disturbance of the market and, equally importantly, as a result of the effect on confidence in industry generally and engineering activities in particular. These effects cannot be quantified but seem likely to be such as to have a significant impact on the effectiveness of Government industrial policy as a whole.

II. Regional Implications and a Regional Response

2.1 The assumptions in paragraph 1.2 above do not have any immediate effect on the North and North West regions of England or on Scotland, although subsequent rationalisation of an independent LVL could lead to job losses in these regions at a later stage. The problems of South Wales would be exacerbated by BL job losses at Llanelli and Cardiff and supplier redundancies but it is clear that the main impact would be on the West Midlands conurbation and Oxford. Even the most optimistic assumptions about this effect lead to the conclusion that the levels of unemployment in many West Midlands travel-to-work areas and in the Oxford area would rise rapidly to more than double figure percentages.

2.2 The traditional response to this level of unemployment has been to grant assisted area status to the region concerned as was done recently in the case of Corby. Were this response to be adopted, the levels of unemployment would suggest at least Development Area status with all that that implies by way of quasi-automatic eligibility for all qualifying manufacturing firms for regional development grants at 15%, selective financial assistance under Section 7 of the Industry Act and a Government Factory programme.

2.3 Such a response would be extremely costly; it is however the response which will be most pressed for since it offers the greatest scope for providing assistance. Regional Development Grant expenditure would be of the order of £155-£170 million a year; about £20 million a year would be required at peak (some 2-3 years after designation) for selective financial assistance (SFA); and, about £25 million for a government factory programme. It would also be necessary to create a new regional development grants' office with a staff of 150-170 or, more probably, to expand the capacity of existing RDGOs to the same extent while some 35 extra staff would be required in the West Midlands (30) and South Eastern (5) regional offices. In addition 20 extra staff would be required at Headquarters whatever remedial action was to be taken.

2.4 The areas concerned do however have considerable geographical advantages over the traditional assisted areas; well established industrial infrastructures; a wide range of labour skills; a proven history of entrepreneurship; and, outside the motor industry, a reasonable industrial relations record. In these circumstances, although it would be regarded as a derisory response locally, designation as an Intermediate Area could be considered as an alternative to DA status. Costs would be much lower (£35-£45 million per annum, at peak (SFA), and £25 million for factories) and only some 35 regional staff would be needed (and the 20 at Headquarters). SFA could be used to attract BL takers for the abandoned BL facilities.

2.5 A major increase in the size of the Assisted Areas, especially of areas close to the South East, would be bound to reduce the effectiveness of regional policy, involving as it would an extension of the AA coverage to about 50% of the working population of Great Britain. There would be a high probability of the diversion of investment from Scotland, Wales and the North East and some less harmful diversion from the South East and East Anglia (including Milton Keynes and, possibly, dockland). The diversionary effect would be reduced substantially if the areas were only given IA status. The regional response could not, of course, be expected to achieve quick results.

III Industrial Consequences and possible Responses

3.1 Although this paper does not consider the consequences of the loss of BL's production for the balance of payments, it is relevant to note that the other major British based assemblers are unlikely to be able to take up more than a small proportion

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of the lost BL market share from their UK production nor are they likely to absorb much of the labour which BL releases or of the capacity which is made available in the supplier industries. The only other significant assembler in the West Midlands is Talbot, which is shedding labour and its future is only marginally more secure than that of BL.

3.2 In these circumstances the loss of BL business can be seen as an absolute loss of that part which it represents of the home market for the component supply and other supporting industries. Taking account of in-house production in the multinationals and their policy of dual sourcing, BL as a whole represents some 50% of the UK market for British component suppliers and the greatest proportion of this is related to those elements of the company's activities which paragraph 1.2 above implies will be lost.

3.3 Although major firms in the supply industry such as Lucas, GKN, Associated Engineering and Automotive Products could be expected to survive this blow as a result of their diversified activities and overseas involvement, many of their individual operations would be put at total risk and in such circumstances they would be likely to respond by closing down a number of their British operations and meeting the greatly reduced demand in this country from their Continental and other facilities. British Steel would be seriously affected (but this paper does not seek to consider these effects) and a number of industries already facing difficulties as a result of fierce overseas competition might be disproportionately damaged eg, industrial fastenings and bearings.

3.4 The overall effect would be to undermine the UK motor vehicle component industry and it would be necessary to consider whether steps ought to be taken to support activities which could be regarded as essential in the long term interests of the economy. Parts of Lucas would come into this category and perhaps in particular the company's efforts to move into the field of micro-electronic car management. To the extent that a high proportion of the component industry is located in the West Midlands, a regional solution of the sort outlined in Section 2 above would provide scope for some assistance but both within and outwith these areas consideration could be given to the use of Section 8 of the Industry Act with some relaxation of the present criteria to provide flexibility. If the West Midlands connurbation and Oxford were designated as DAs some £20 million would be needed over a 4-5 year period; if they become IAs this figure is likely to rise to £35 million, and of the order of £50 million is likely to be required if they are not given AA status. Some extra expenditure is also likely to a rise in support of new product and process development.

IV. Short Term Measures

4.1 A wide range of firms in the component supply and associated industries would be faced with a period of re-assessment and re-appraisal, many, particularly smaller sub-contracting companies which are substantially dependent on BL's volume car production, would have no alternative but to cease trading; others would need time either to adjust their manning levels and facilities to a lower level of business or to seek alternative business. At the smaller end of the scale the latter would be in the minority. In these circumstances limited short term financial support would provide the essential breathing space for adjustments to be made.

4.2 A number of possibilities exist; guarantees of bank lending might be one avenue but this carries with it open-ended commitments and substantial administrative difficulty both in identifying deserving cases and in monitoring performance. Special schemes could be considered under Section 8 of the

Industry Act for particular sectors of industry but the wide diversity of suppliers would make it difficult to identify appropriate groups and to administer such schemes and they would not offer quick help. On balance, it seems best to rely on the Department of Employment's temporary short time working compensation scheme which appears to be ideally suited to a situation in which many companies would be faced with a choice between immediate redundancies and a period of re-adjustment. A reliance on this scheme (which provides assistance for a maximum of 6 months) with some streamlining of administrative procedures but without any changes in its basic guidelines would not call for any new legislative measures and all that would be needed would be to draw attention to it. On the basis of the assumptions in paragraph 1.2 above, costs might be in the order of £50 million. Department of Employment could probably cope with the increased volume of business provided Department of Industry gave specialist support. This position could change however if the inevitable increases in unemployment placed an undue strain on Department of Employment's other services.

4.3 Most firms with a prospect of survival will of course rely heavily on their banks to carry them through the difficult period after a BL collapse. In these circumstances it would seem desirable for the Government, through the Bank of England, to ask the Clearing Banks to respond sympathetically within the limits of commercial prudence to the short term financing needs of BL suppliers. The banks would almost certainly seek in return an indication that, to the extent that they did help out, the Government would be sympathetic to any resultant difficulties arising under monetary policy constraints.

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V. Protective Measures

5.1 The loss of BL's volume car production and the likelihood that other UK assemblers would be unable to make up for this to any appreciable extent will undoubtedly increase pressure for import controls. Such pressure is likely to be exerted both by the current advocates of protectionism and by certain elements of the component industry. It is difficult, however, to see what such a course of action would achieve in these circumstances, even if it were permissable under the Treaty of Rome or the GATT. The multinational assemblers could not respond quickly by increasing their UK production and would be most unlikely to be prepared to break from well established patterns of European integration. Although the Japanese might be encouraged by such measures to contemplate investment in this country in order to protect their market share, such a response would have no short term effect at all. In short the import controls argument seems relevant only in the context of BL staying in business, possibly as a means of keeping up its market share; in the absence of BL it is difficult to perceive any value at all in going down such a route.

VI. Summary and Conclusions

6.1 The effect of a partial collapse of BL from which Leyland Vehicles, Jaguar and Land Rover survived with some limited supporting activities would be to put a total of some 160,000 jobs at risk of which the largest proportion would be in the West Midlands and at Oxford. It would represent an absolute loss of a substantial proportion of the home market for British component suppliers many of whom at the smaller end of the scale would inevitably go out of business while others, including some of our largest companies, would be placed in serious difficulty in respect of some of their discrete activities. Other car assemblers could not be expected to fill more than a small part of the gap in UK car availability and substantial further imports would therefore arise.

6.2 We have been unable to identify any measures which would be likely to make much impact on the resulting industrial and regional consequences; but some contribution could be made under support schemes and policies which already exist. It is suggested that consideration could be given to:

a) A traditional regional response whereby assisted area status would be accorded to the West Midlands connurbation and Oxford. Likely levels of unemployment suggest Development Area status which would however be extremely expensive and would certainly detract even further from the limited attractions of the peripheral areas of the UK for which the policy is mainly designed;

b) Alternatively and having regard to the geographical and other advantages of the areas a preferable approach would be to give Intermediate Area status. This would substantially reduce the diversionary effects and the potential costs;

c) More flexible use of Section 8 of the Industry Act. To enable support to be given to key component suppliers capable of making a significant contribution to the economy whose activities would be put at risk by the loss of BL business and to seek to attract new capital intensive industry to the affected areas; and

d) Positive use of the short-time working compensation scheme within the established criteria but adopting more streamlined administrative procedures to prevent delays coupled with pressure on the clearing banks to adopt a sympathetic attitude to the demands of firms affected by the loss of BL business.

The regional response would require EEC clearance as would any significant changes in the guidelines for the administration of Sections 7 and 8 of the Industry Act. Additional support could also be sought from the Community; greater use of EIB funds would however require an increase in the £200 million limit set for 1980-81.

6.3 Cost estimates can only be approximate. A DA solution would cost about £135-£190 million in a peak full year plus £20 million under Section 8 and £25 million for a Government factory programme each over 4-5 years. IA status would reduce the peak annual spend to £35-£45 million but would increase the Section 8 figure to some £35 million with the factory programme remaining at £25 million. Reliance on Section 8 alone would be likely to cost about £50 million over 4-5 years. The Department of Employment expenditure of c £50 million would all arise within a year of the closure of BL facilities under any of these options. None of these sums could be met from current estimate or PESC provisions.

6.4 Apart from the regional staffing implications (185-200 extra staff for the DA option and 35 for an IA solution) there would also be a requirement for about 20 extra staff in DOI Headquarters. Even the lower figures would be difficult to accommodate within reduced manpower estimates and the higher figures certainly could not. New trained staff could not be provided quickly and in the short and medium term a considerable extra burden would be imposed on existing staff which could not be sustained for long.

6.5 As indicated in paragraph 1.3, this paper has only sought to consider the first line effects of a partial BL collapse and has not attempted to examine the wider implications for the economy as a whole or for industrial policy. This is clearly an area of great uncertainty but there cannot be any doubt that an industrial disaster of this magnitude would have a significant and damaging effect far beyond the company itself and its dependent suppliers.

DEPARTMENT OF INDUSTRY
31 March 1980