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PRIME MINISTER

STEEL STRIKE: LONGER TERM EFFECTS

Keith Joseph is in Copenhagen today, and rather than hold back this letter, has asked if I would write on his behalf.

Officials in the Department of Industry have prepared the attached assessment of the medium and longer term effects, on steel users and on the economy more generally, of a strike lasting until the end of March. Any assessment of this kind must be tentative and subject to wide margins of error. It is particularly difficult to judge the speed and extent of unemployment which might develop during March, on which the paper could be pessimistic. Production in the steel using industries has so far kept up a lot better than might have been feared and the CBI confirm officials' impression that today most firms are facing the prospect of a continuing strike with remarkable unconcern. However, we would expect to find a very sharp turn-round in attitude, and to come under considerable pressure from employers, as soon as shortages started to bite.

The most significant expectation is that a three-month strike would cause GDP over 1980 as a whole to be only 0.25% lower than it would be otherwise. Though the immediate effects on production could be sharp, experience suggests strongly that most ground lost would be recovered very quickly once the strike ended. We must however reckon also with unquantifiable longer term damage from export delivery failures and delays and from a general further weakening of companies for which this is the third major strike in fifteen months, and which have got so many other difficulties to face. In some sectors

/ ... lasting damage



lasting damage could be severe; in particular British Leyland's Corporate Plan would probably have to be abandoned - though this is on the cards anyway.

On the whole the paper makes the prospect appear less daunting than might have been feared. If the projection (which at present seems an exaggeration) of 200,000 lay-offs by end February and 500,000 by end March were fulfilled we would clearly come under very strong pressure from both sides of industry to end the strike. Even so, if we were prepared to face this the paper implies that the longer term economic damage would not be intolerable. My own instinct is that the deeper, longer term effect would be greater than suggested.

Against the risk of damage have to be set the vast tangible and intangible gains if the BSC reached a pay settlement on substantially self-financing terms, bringing real improvements in productivity and competitiveness.

I believe it would be useful to put it about unattributably to the media that a continuing strike would be sustainable. Hopefully the feeling that holding out would not succeed might make the unions readier to settle. We certainly appear to have two or three weeks at least when the pressures on the unions from their own members and others should not be matched by pressures from employers.

I am copying this minute to Members of E Committee, the Secretaries of State for Scotland and Wales, the Paymaster General and Sir Robert Armstrong.

ACB.

ACB

15 February 1980



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LONGER TERM EFFECTS OF A CONTINUED STEEL STRIKE

Introduction

So far the strike has had little general effect on the steel-using industries. Up to early February industrial production, excluding BSC itself, was 99% of normal and in the week ending 9 February loss of production even in the metal-using sector was no more than 2%. This paper attempts to assess the impact on users if the strike lasted for 3 months till the end of March.

2 The assessment is subject to considerable uncertainties and the timing of anticipated effects is very variable. It depends on whether imported steel continues to flow; whether demand from its own customers holds up to the end of a particular firm's endurance; whether shortages of special steels, harder to predict and liable to cause dislocation, occur; the preparations particular firms have made; and the nature and extent of picketing. Many steel-dependent firms should be able to produce at near-normal level until around the end of February by drawing on new supplies and stocks; there is a wide variation between firms. After that, production might begin to run down quite fast though a good many firms are likely to be able to continue at a reduced level.

Steel-consuming Industries

3 The industries substantially dependent on iron and steel account for 30% of net manufacturing output, 32% of employment and 32% of exports. The annexed table indicates the major consumers and their importance to the economy. Mechanical engineering represents about 7½% of output and the motor industry another 6½%. Other significant users are industrial plant and steelwork, electrical machinery and shipbuilding.

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4 The interruption of steel supplies is the latest of a series of major strikes - the oil tanker drivers/road haulage drivers in early 1979, the nine-week stoppage at Ford's, and the engineering workers' strike in mid-1979. Resilient though much of UK industry may have been in the past, the cumulative effect of another protracted period of disruption would be to weaken manufacturers further against foreign competition, though the impact of the disputes would be expected to be long-drawn-out rather than dramatic. As an illustration - not necessarily typical - Lucas Industries says that the engineering dispute cost them £20 million in profits. This may be compared with their 1978/79 year's net profit before tax of £71 million (£29 million on an inflation-accounting basis).

5 In a year when prospects for world trade are depressing, overseas customers may have further reason to lose confidence in the UK as a reliable supplier. At home customers will now be drawing upon imports, and once overseas suppliers have further penetrated the UK markets experience suggests that they will not be easy to dislodge. Multinationals established in the UK may decide to adjust their inter-group supply patterns to the UK's disadvantage.

6 Cash shortages may be expected to hit steel-using firms hardest a month or so after their own production ceases. The cash flow of firms supplying the steel industry will, of course, be damaged sooner. Besides firms who are already weak, smaller concerns will be most vulnerable. The banks have scope to provide extra credit within existing monetary policy but many firms would find this expensive at current rates of interest. Other factors besides higher financing charges will be adverse: production during the steel strike and after will not be optimal, overheads, purchasing and stocking costs per unit will be higher, and quite possibly lay-off payments will have to be made as well.



7 In turn profitability will be threatened in a year when inflation-adjusted profits for many manufacturing firms are anyhow expected to be barely positive. Caught between their wage, material and energy costs on the one hand and interest and dividend payments (which they will be reluctant to reduce) on the other, the affected firms would probably choose to cut their capital spending and R & D programmes, so increasing the advantages enjoyed by their overseas competitors.

8 Any assessment of the effects of the strike on employment in the steel-using industries and in the many other industries dependent on regular supplies of products based on iron and steel can only be speculative. If we assume that the average loss of output in all manufacturing industry during February will be 5% (probably now an exaggeration), lay-offs after starting from a low level could total about 200-250,000 **at the** end of the month. Strikers are not, of course, included in these figures. Taking an average output loss of 10% in all manufacturing industry for March - and at this stage this is a matter of guesswork - the corresponding end-month figures could in theory be as much as 600,000-700,000 layoffs. These figures could be increased somewhat by any "second round" lay-offs resulting for example from shortages of steel-based products, and any lay-offs which occur in firms supplying the steel industry. On the other hand, rather than resort immediately to lay-offs, firms may stop overtime and abandon shift work or bonus schemes etc, to reduce output per man, or switch to a shorter working week. Taking all these considerations into account, a continuing strike could lead to lay-offs in the region of half a million by the end of March.

Some Vulnerable Sectors

9 The heavy dependence of the motor industry on BSC steel, especially for car manufacture, leaves them exposed. BL have maintained production to date; in BL Cars lay-offs are now imminent as a result of the company's stock levels and low January market share (not the steel strike), and these



will obviously improve the company's ability to maintain other production. Leyland Vehicles, which will not be affected by the lay-offs, will from now on experience some difficulty in maintaining full production. The lay-offs should lessen the immediate financial and production effects of the strike, though the extent is as yet unquantifiable. The current best estimate of a strike which ended in the next week is the loss of up to 20,000 vehicles and £26m in cash (spread over several months)*. A strike ending end-February would cost BL an estimated £45m and 55,000 vehicles. This is about 3½ weeks' production at normal output. A strike of this duration could well make the BL Board think very seriously (along the lines of the assurance given to the Secretary of State in December) about the future of the company's Corporate Plan; a strike lasting for three months to end March, which BL forecast could cost them the loss of 130,000 vehicles and up to £106m in cash would, we think, make withdrawal of the Plan a certainty.

10 The effects upon Vauxhall have been less severe than expected, although work has just ceased on Bedford heavy trucks owing to a lack of leaf springs. A decision will be taken in the week beginning 18 February with regard to light commercial vehicles, but so far production of cars is not threatened. Since sales of heavy vehicles have been moving slowly, the company are not too concerned about the loss of production. A total shutdown would cost £6m in week 1, and £4-4.5m a week thereafter.

11 The position at Ford is also encouraging in that they now believe they can carry on full production until mid-March. They are not however prepared to offer any assessment of loss levels and cash flow deficiencies thereafter.

* because once production runs down, restarting and refilling the pipeline will take time.



12 Talbot believe that they can go through to the end of February and possibly longer since they have abnormally high levels of stocks of coil and sheet steel accumulated during the 15-week strike last year. Bar steel stocks are not so high and they are worried about their suppliers after the end of the month. They do admit that any cessation of production would bring about a serious cash flow situation and they would encounter early liquidity problems. They still see the prospect of £5m losses per week of total shutdown.

13 In shipbuilding the long-term effect will mainly be on merchant shipbuilding, unless the dispute extends over several months when some naval contracts may also be affected. One firm is discussing with its unions the introduction of a 3-day week from 18 February, and another is likely to follow suit. Delay and uncertainty about future deliveries may deter customers from placing orders; that will increase the industry's costs and make it even less competitive. The additional cost to BS of this disruption is difficult to quantify, but assuming the strike lasts into March, it could be £40 million. This, added to existing financial problems, will make it very difficult for BS to keep within their loss and cash limits, and may well result in further permanent closure and loss of jobs. The effect on the private sector could be similarly severe.

14 Lastly, among the firms expecting problems sooner rather than later, are quite a few of those who rely on special steels. The drop-forging sector, particularly vulnerable to cuts in supplies from private steel companies, already has a limited number of firms on short time.

Tinplate and Food Supplies

15 No tinplate supplies are available from any UK source other than BSC. Metal Box, who produce 85% of food cans, have now laid off 40% of their workers in this part of their business.



They can continue reduced production up to the end of February and have already cut output to half of normal.

16 At this time of year food-canning is normally confined to peas, beans, pet foods and some seasonal vegetables. Any shortfalls in production of these limited lines would not be apparent in the shops for at least 4 weeks (ie mid-March) because of the stocks in the distribution chain. Once the stocks are exhausted a shortage of these goods would occur for a period equal to the time no cans are made, plus a minimum 2-3 week period (necessary for quality control reasons) before new production reaches the shops again. Also, BSC may not be able to supply enough on-grade tinsplate for food-canning immediately they start up. Some limited imports of canned food might go a little way to making up the shortfall.

17 Longer-term canning of the main seasonal fruits and vegetables starts in early July and continues through harvest. The ability of BSC and the can manufacturers, who usually build up their stocks during the winter, to meet this peak demand, will be crucial. If steelmaking were to be delayed until May, their capacity might well be too small; imports of empty cans would almost certainly be uneconomic. The consequent economic loss to farmers and canners might be substantial. MAFF do not at present consider that detailed contingency arrangements need to be made for the production of tinsplate and cans when steelmaking is resumed, though consultations may be needed on priorities for producing food and other cans or between foods if the strike lasts so long that disruption seems likely to continue near to the start of the harvest.

Conclusions

18 At present it appears that the steel strike could last for most of February without causing serious general damage to the steel-using industries. As time has passed, so the expected endurance of most sectors and their fortitude have stretched.



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19 The paper has however indicated the difficulties in which a strike to the end of March could place a number of steel-using industries. Taking these effects together and placing them in a broader, macro-economic perspective, they amount to a reduction in GDP over the first quarter of this year of over 1%. A part, perhaps as much as one third, of this loss in national output could be expected to be recovered in the second quarter of the year as manufacturing activity rebounds in an effort to catch up on the delayed orders on hand. Some additional allowance might have to be made for continuing losses in output later in the year from spill-over effects. Over the year as a whole the effect on GDP might be of the order of one-quarter of 1%. Prior to the strike GDP was forecast to fall by as much as 2% in 1980; as a result of the steel strike, this decline might be 10-15% greater than it would otherwise have been.

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20 Preliminary calculations indicate that lay-offs might exceed half a million by the end of March.

21 The banking sector seems capable, with appropriate encouragement, of coping with the immediate effects of the strike on corporate liquidity but the strike is bound nevertheless to accentuate the liquidity difficulties of the corporate sector in the year as a whole. The PSBR is likely to increase marginally, assuming that no substantial extra funds are made available to the nationalised industries affected by the strike. Reduced activity in manufacturing will depress tax revenues and temporary redundancies will necessitate increased social security payments.

22 The longer-term consequences of the strike on export performance are necessarily speculative. If it starts biting seriously into output the strike can only reinforce Britain's reputation for unreliable delivery dates but there

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are other factors to be considered. The comparatively long delivery dates which British manufacturers tend to offer, provide some room within which to recover some of the effects of the strike. At best our manufacturing performance would continue on its present unsatisfactory trend; at worst it may deteriorate. We would not expect this deterioration to be significant overall in the long term if the strike ends before April.

23 Finally, much depends on how the strike ^{wage} is ended. If BSC secured a substantially self-financing/settlement the benefit to wage settlements generally, to inflation, to industrial morale and to foreign confidence in the UK economy would be incalculable.

Department of Industry
13 February 1980

TABLE

NET OUTPUT, EMPLOYMENT AND EXPORTS OF SELECTED STEEL-USING INDUSTRIES \emptyset

	Percentage of iron and steel industry's output purchased \emptyset	1977*				1978*	
		NET OUTPUT		EMPLOYMENT		EXPORTS	
		£ million	% of all manufacturing	Thousands	% of all manufacturing	£ million	% of all manufacturing
Iron and steel (general)	25.2	1,412	2.7	237	3.2	815	2.6
Steel tubes		294	0.6	45	0.6	237	0.8
Pumps, valves and compressors	1.5	638	1.2	91	1.2	496	1.6
Construction equipment	3.3	384	0.7	42	0.6	795	2.5
Mechanical handling equipment		473	0.9	66	0.9	365	1.2
Other non-electrical machinery	4.8	1,509	2.9	173	2.3	1,249	4.0
Industrial plant + steelwork	7.6	1,411	2.7	171	2.3	608	1.9
Other mechanical engineering	3.1	949	1.8	164	2.2	331	1.0
Electrical machinery	2.4	958	1.8	142	1.9	777	2.5
Domestic electrical appliances	1.1	318	0.6	62	0.8	185	0.6
Shipbuilding and marine engineering	2.1	919	1.7	176	2.4	453	1.4
Motor vehicle manufacture	10.0	3,490	6.6	494	6.6	2,853	9.0
Engineers' small tools and gauges	1.2	354	0.7	61	0.8	117	0.4
Hand tools and implements	/	108	0.2	19	0.2	96	0.3
Bolts, nuts, screws, rivets etc	1.1	203	0.4	35	0.5	65	0.2
Wire and wire manufacture	5.5	253	0.5	38	0.5	133	0.4
Cans and metal boxes	3.5	181	0.3	28	0.4	41	0.1
Other metal industries	10.8 /	1,876	3.6	317	4.3	559	1.8
Total of above	83.2 \emptyset	15,730	29.9	2,361	31.7	10,175	32.2
All manufacturing industries	n/a	52,534	100.0	7,456	100.0	31,561	100.0

\emptyset Industries selected are those that purchased at least 1% of the total amount of iron and steel industries' output, based on provisional 1974 results

* Latest year for which full information is available

/ The share of hand tools and implements is included under other metal industries