CONFIDENTIAL
COMMERCIAL IN CONFIDENCE

Qa 05196

To: MR LANKESTER
From: J R IBBS

3 December 1980

Steel

1. At E on Thursday Ministers will be discussing two papers on Steel by the Secretary of State for Industry. Prospects for Steel (E(80)139) outlines the likely scale of capacity reductions and efficiency improvements necessary to create a viable steel industry. Whilst in the British Steel Corporation and the Private Sector Steel Companies (E(80)138) Sir Keith Joseph seeks colleagues' approval to the principles to be followed by his officials in aiding the detailed negotiations between the interested parties aimed at a shift of emphasis from public to private ownership through joint ventures in the billet, bar and rod sector of the market.

Prospects for Steel

2. Clearly it is impossible to take an overall view of future viability of the steel industry without either the BSC corporate plan or detailed plans for particular collaborative ventures. However, in assessing future viability of either BSC or the proposed joint ventures it is worth underlining the crucial role played by the sterling exchange rate. The level of sterling has a dual effect on the steel industry:

(i) it has a direct effect on competitiveness against international competition since prices tend to be Deutsche Mark determined while the steel industry's costs are largely sterling based;

(ii) but there is also a volume effect to the extent demand from steel industries consumers is also affected by the relative international competitiveness of the United Kingdom manufacturing sector.

In view of this, the CPRS would propose that when the BSC plan or particular joint ventures are considered the sensitivity of their viability be assessed against a range of sterling exchange rates likely over the medium-term.

3. Even if BSC achieves the goal of European productivity standards it is clear that this alone will not guarantee profitability. In addition to being subject to sudden appreciation in sterling it is also competing in an artificial international market where there is substantial excess capacity and widespread Government subventions.

The BSC and Private Sector Companies

4. The CPRS believes that the proposals on collaborative joint ventures, shifting the emphasis away from the public to the private sector, deserve positive support from Ministers. These schemes will obviously require very skilful financial juggling to ensure commercial viability and to make sure that resulting ventures fall outside the PSBR. As Sir Keith Joseph's paper brings out this will require a flexible approach to meet several types of problem but will inevitably require Government assistance in one form or another, channelled through BSC. In the view of the CPRS such dowries deserve serious consideration on the grounds that:

(i) the amounts required are expected to be significantly less than would be required to finance the business if it remained within the public sector;

(ii) once in the private sector there should be greater efficiency from more rational decision-making without political or short-term PSBR constraints.

In short, this seems a very promising line of approach for moving some unsatisfactory parts of the nationalised industries into the private sector. The provision of a dowry in suitable circumstances should prove a sound investment.

5. Given the continuing losses some of the private sector companies are incurring there is, however, an obvious urgency to some of the negotiations. If, for instance, the Duport Group were to go under, then an order book which could be a useful element in putting together

a collaborative venture would be lost. There is clearly a danger in the trading conditions likely to exist over the winter that some options may disappear and this could jeopardise the objective of an enhanced private sector share of the billet, bar and rod market. This underlines the need for strong support for what the Secretary of State is attempting, so that any sound moves that prove feasible suffer minimum delay.

6. I am sending a copy of this minute to Sir Robert Armstrong.

JR