Ref. A04162

PRIME MINISTER

British Steel Corporation: Corporate Plan

(E(81) 11, 13 and 14)

BACKGROUND

The Secretary of State for Industry summarises his recommendations in E(81) 13. E(81) 11 covers a detailed report by an Interdepartmental Group of Officials. In E(81) 14 the CPRS raise some questions on the proposed approach.

2. BSC have presented a short term recovery plan up to 1981-82 rather than a Corporate Plan looking to the medium term and discussing the options. Essentially Mr MacGregor is asking for time until July to decide which businesses have a chance of viability by March 1982. In the meantime he is assuming capacity to produce 14.4 million liquid tonnes per annum rather than the 12½-13 million liquid tonnes per annum which he had in mind last September.

3. This assumption of capacity seems optimistic. Officials judge that it should be possible to make internal improvements in productivity and to achieve necessary manpower reductions. External factors, however, are strongly against BSC. In particular:

(i) the Deutschemark is the main determinant of their competitiveness with European producers. They have assumed 4.20 DM to the £ in 1981-82. It is 5.0 today. A variation of 10 per cent effects BSC's profit/loss by around £200 million (see paragraph 20 of E(81) 11).

(ii) The present European Community production quotas run out in June 1981 and negotiation of their extension will be very difficult - the German Government have already said they will not support extension of mandatory, as distinct from voluntary, arrangements (paragraphs 21 and 22 of E(81) 11).

(iii) Demand for steel has to pick up and BSC have to keep their 54 per cent share of the UK market.

4. The advice is that the costs of a run-down starting in July could be somewhat lower than one starting now, because in the meantime manpower and other cost reductions would be made. The Government would however have to finance continuing running costs over this period and these are put, at the very outside, between £350 million and £450 million (paragraph 7 of E(81) 13). Against this background the Secretary of State for Industry recommends that the Government should accept the plan for the moment and wait for Mr MacGregor's further recommendations in July. In this way the Govenment would be seen to be backing MacGregor's commercial judgement and giving the Corporation a reasonable chance. The decision would not involve long term commitments: BSC would not enter into major capital investment commitments without the Government's prior approval; it is practicable to close down parts of the Corporation if necessary; and plans for joint ventures with the private sector are proceeding. It is tentatively estimated that the PSBR costs of funding the plan from 1981-82 to 1983-84 would be £1, 430 million compared with £2, 530 million for the rapid run-down of the Corporation. (See Table in paragraph 32 of E(81) 11).

5. If this approach were accepted, Mr MacGregor would report further in July with, if necessary, proposals for major closures to take account of internal and external factors and the financial targets set him. Officials recommend that he should also be required to submit a Corporate Plan, as early as possible in the Autumn, for 1982-83 to 1984-85. In the meantime officials are considering possible remedial measures for areas effected, and they wish to discuss further with the Corporation the levels of redundancy payments offered by BSC and the possibilities of converting some or all of BSC's profit centres into subsidiaries subject to the Companies Acts.

6. If the immediate proposals are accepted it is recommended that:-

(i) the 1980-81 EFL should be increased by £150 million to £1, 121 million (NB it had been expected that the increase would be of £200 million).

(ii) The 1981-82 EFL should be set at £730 million (which would allow for a wage freeze from January to July 1981 and then a 7 per cent increase).

(iii) Financial targets should be announced of a loss limit before interest of £225 million in 1981-82 (compared with an estimated loss of £480 million in 1980-81) and break-even for 1982-83. CPRS suggest (paragraph 3 of E(81) 14) that the 1982-83 figure should be presented as an "aim", open to revision, rather than a target.

(iv) The Iron and Steel Bill (which will be discussed by Legislation Committee on Wednesday) should provide for the writing-off of £3, 509 million of capital immediately with a power to write-off a further £1, 000 million later.

(v) The Secretary of State for Industry should announce the Government's response to the BSC Plan on Monday 9 February and publish the Iron and Steel Bill at the same time.

HANDLING

7. After the Secretary of State for Industry has introduced his paper the Chancellor of the Exchequer will wish to comment on the general approach and to confirm whether he is content with the detailed financial proposals; and Mr Ibbs will wish to speak to his paper. Of the other Ministers, the main interest lies with the Secretaries of State for Employment and Wales and Lord Mansfield (who is representing the Secretary of State for Scotland). The Foreign and Commonwealth Secretary may wish to comment on the possibilities for securing the cooperation of our EC partners in the extension of quotas.

8. The first question is whether the Committee agrees that BSC should be funded until July. If so, they will need to give specific approval to the figures for the EFLs, the financial targets, and for the capital reconstruction for which the Iron and Steel Bill will provide. (The Business Managers are particularly concerned to make urgent progress with this Bill in the interest of the management of the overall Legislative Programme).

9. The Committee will also wish to consider the extent to which decisions in July should rest on the commercial judgement of Mr MacGregor within the framework of the financial targets set him. As CPRS point out in paragraph 5 of E(81) 14, BSC might by then meet their own internal objectives for productivity, redundancies and pay, but external factors - the Deutschemark,

failure to agree European Community quotas, and demand - could be against them. If major closures were then proposed the workforce could claim that they had done all that was asked of them and that major parts of the business were being sacrificed to short term financial objectives. With that in mind, the Committee may wish to consider whether they intend that Mr MacGregor should be left to take decisions on closures according to his commercial judgement and within the targets set to him, or whether Ministers will wish to reserve the right to consider this further in July in the light of developments. If the Committee decides on the latter approach, this will have to be made clear to Mr MacGregor, together with any particular points which they wish him to take on board. The Committee might also wish to consider whether in the meantime officials ought to do further work, preparatory to the July decisions, on whether any strategic case might be mounted for postponing closures if seemed that the problem centred on external factors, which might improve beyond the short term, rather than internal improvements - see paragraph 6 of E(81) 14.

10. In any event the Committee will no doubt wish to endorse the recommendation by officials (which the Secretary of State for Industry does not pick up in his paper) for the preparation as soon as possible in the Autumn of a full-scale Corporate Plan looking several years ahead and showing some of the options. Otherwise there is a risk that Mr MacGregor will present Ministers with a series of short term propositions to which, each time, it will be difficult to say no.

11. You may also wish to invite the Secretary of State for Industry to circulate a draft of his statement to the House. In particular this will need to strike the right note on the extent to which decisions rest with the BSC Board rather than the Government and the extent to which they will be determined by external factors.

CONCLUSIONS

12. You will wish to sum up with reference to the Secretary of State for Industry's six points in paragraph 14 of E(81) 13: namely approval of the Plan; EFLs; financial targets; capital reconstruction; support for extension of EC quotas; and an announcement, with publication of the Iron and Steel Bill, on Monday 9 February.

13. You may also wish to invite the Secretary of State for Industry:-

(i) to circulate a draft of his statement, taking account of the points made in discussion;

(ii) to impress on Mr MacGregor the need for a full-scale Corporate Plan as soon as possible in the Autumn;

(iii) to commission any further work by officials, which the Committee may judge to be necessary, in preparation for the July decisions and in addition to the further work proposed on redundancy payments and the setting up of subsidiaries under the Companies Act.

(iv) to report further on progress in setting up BSC/private sector joint ventures - as recommended by the CPRS in paragraph 4 of E(81) 14.

for ROBERT ARMSTRONG

2 February 1981