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PRIME MINISTER

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For Tuesday's meeting. The Scottish Office / Treasury paper on the cost of closing Ravenscraig will come on Monday.

BSC: FUTURE STRATEGY

Please also Mr Jenkins's letter to Mr Jophing <sup>Reg A</sup> (attached). HCS 10/12

At the meeting on Monday 6 December I was asked to circulate a paper setting out in more detail the financial consequences of the options which were under consideration for BSC's future strategy, for consideration at a further meeting now arranged for Tuesday 14 December.

2 BSC have now provided a more up-to-date and detailed projection of the likely profit and loss and cash requirements of BSC over the next 3 years. The projections are reproduced at Annex A. They have been prepared on 4 alternative options.

- A Ravenscraig stays open, the Port Talbot Hot Strip Mill project goes ahead.
- B Ravenscraig closed, the Port Talbot HSM goes ahead.
- C Ravenscraig stays open, Port Talbot HSM shelved.
- D Ravenscraig closed, Port Talbot HSM shelved.

3 The figures in Annex A illustrate the effects of going ahead with the proposed modernisation of the Port Talbot HSM project. However, there are two points to note. First, the figures do not show the full benefit on profitability because the project will not be completed until 1986, i.e., beyond the period covered in the table. Second, the figures are perforce approximate because BSC are still completing their re-evaluation of the project in the light of the latest demand forecasts for strip mill. However, they estimate that the minimum full year benefits from the project, if all 3 strip mills remain in operation, would be £25 million a year. If Ravenscraig were closed, enabling the modernised Port Talbot HSM to be run at a higher throughput, then



annual savings from the project by 1986/87 could reach £39 million.

4 BSC are not expecting Government approval for the project at this stage. They know that they need to provide a proper and up-to-date justification for it in the context of the Corporate Plan. They know too that we shall have to negotiate approval for the project with the Commission. While therefore, in my Statement to the House, I must be careful to make it clear that the Government are not yet in a position to give approval for the project, I think we must be prepared to indicate (if we so agree) that subject to the full appraisal and subject to the Commission's approval we would be prepared to see the project go ahead. Nicholas Edwards would wish me to go further and accept the case in principle. I do not see how we could do this without making the formal appraisal meaningless and without seeming to "bounce" the Commission. I would propose therefore that we should deal with the matter along the lines of the following passage:-

"The Port Talbot hot strip mill is now 30 years old and in need of modernisation. A project proposal has been put forward by the BSC which would cost some £175 million and take 3 years to complete. The Government fully appreciates that it is important that the mill should operate to the highest standards of efficiency and has therefore instructed the Corporation to prepare a considered case based on the up-to-date estimates of demand for the product. The project would also need the approval of the Commission. I would hope to be in a position to announce the Government's decision when I report to the House on the BSC's Corporate Plan."

5 If BSC cannot reach breakeven in 1984/85, then under the terms of the ECSC State Aids for Steel Decision we will not be able to provide the Corporation with operating subsidies beyond 31 December 1984.



6 We may in any event face difficulties with the Commission over the new BSC cash projections. The total cash requirements now shown are higher than provided for in our final aid application in respect of BSC which we submitted in September. At that time we estimated that BSC's requirements for Government finance for its operations would be £1,160 million over the period April 1982 to December 1985. We are likely to face difficult negotiations with the Commission, when BSC's new plan for 1983/86 has been received, over the question of BSC's overall viability and on the higher volume of Government finance required, if Ravenscraig (or another works) is not closed by 1985. Potentially, these issues are more difficult than obtaining Commission approval for the Port Talbot Hot Strip Mill project, for which (as I explained in my paper dated 2 December) I believe we could secure approval by means of a contract limiting the output of the new hot strip mill.

7 In the light of these latest BSC cash projections I consider that we must allow BSC the greatest possible freedom to cut their costs by reducing their operations, if we decide we cannot allow the closure of one of the 5 major integrated steelworks. I attach a draft Statement which explains our position clearly, but which does give BSC considerable management freedom on how they operate while planning on the basis that they maintain steel-making at all 5 major works.

8 I am sending copies of this minute to Francis Pym, Geoffrey Howe, George Younger, Nicholas Edwards, Norman Tebbit, Arthur Cockfield, Sir Robert Armstrong and John Sparrow.

PJ

P J

10 December 1982

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## BSC FINANCIAL PROJECTIONS 1983/84 to 1985/86

## LATEST BSC CENTRAL ASSESSMENT

|  | £ million              |                       |                       |                       |
|--|------------------------|-----------------------|-----------------------|-----------------------|
|  | Current Year<br>1982/3 | Plan Year 1<br>1983/4 | Plan Year 2<br>1984/5 | Plan Year 3<br>1985/6 |
| A Ravenscraig stays open,<br>the Port Talbot HSM<br>project goes ahead |                        |                       |                       |                       |
| i) Profit/(Loss)<br>after interest                                     |                        | (214)                 | ( 90)                 | ( 94)                 |
| ii) Contingency  |                        | (100)                 | (100)                 | (100)                 |
| iii) Profit/(Loss) after<br>interest & contingency                     | (337)                  | (314)                 | (190)                 | (194)                 |
| iv) Cash (including<br>contingency)                                    | (505)                  | (520)                 | (350)                 | (250)                 |
| B Ravenscraig closed,<br>the Port Talbot HSM<br>goes ahead             |                        |                       |                       |                       |
| i) Profit/(Loss)<br>after interest                                     |                        | (139)                 | 10                    | 6                     |
| ii) Contingency  |                        | (100)                 | (100)                 | (100)                 |
| iii) Profit/(Loss) after<br>interest and<br>contingency                | (337)                  | (239)                 | ( 90)                 | ( 94)                 |
| iv) Cash (including<br>contingency)                                    | (505)                  | (510)                 | (300)                 | (160)                 |
| C Ravenscraig stays<br>open, Port Talbot<br>HSM shelved                |                        |                       |                       |                       |
| i) Profit(Loss)<br>after interest                                      |                        | (214)                 | ( 95)                 | (110)                 |
| ii) Contingency  |                        | (100)                 | (100)                 | (100)                 |
| iii) Profit((Loss) after<br>interest and<br>contingency                | (337)                  | (314)                 | (195)                 | (210)                 |
| iv) Cash (including<br>contingency)                                    | (505)                  | (470)                 | (310)                 | (240)                 |

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|   | Current year<br>1982/3 | Plan Year 1<br>1983/4 | Plan Year 2<br>1984/5 | Plan Year 3<br>1985/6 |
|---|------------------------|-----------------------|-----------------------|-----------------------|
| D Ravenscraig closed,<br>Port Talbot HSM<br>shelved     |                        |                       |                       |                       |
| i) Profit(Loss)<br>after interest                       |                        | (139)                 | 0                     | ( 9)                  |
| ii) Contingency   |                        | (100)                 | (100)                 | (100)                 |
| iii) Profit/(Loss)<br>after interest<br>and contingency | (337)                  | (239)                 | (100)                 | (109)                 |
| iv) Cash (including<br>contingency                      | (505)                  | (406)                 | (270)                 | (150)                 |

Note: BSC are seeking to make further cost savings in 1983/84. These may reduce loss figures in that year by up to £100 million under each option. But there may not be a matching improvement in later years, since the new cost reduction programme is likely to include measures brought forward from 1984/85 into 1983/84.

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## BSC FUTURE STRATEGY : DRAFT STATEMENT

1 With permission, Mr Speaker, I should like to make a statement about the future strategy of the British Steel Corporation.

2 The House is already aware that the crisis affecting the steel industry world-wide poses severe problems for the British Steel Corporation. Last Spring, BSC just about broke even and the prospect for the current year, 1982/3 was for a very small profit after interest. However, following the American protectionist measures and the sharp downturn in world markets for steel, BSC is again making heavy losses, now running at over £7 million a week. The management has therefore been engaged on an urgent reappraisal of its prospects and of the steps necessary to stem these mounting losses.

3 In my speech to the House on 9 November I made it clear that the BSC management had the responsibility for

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taking such steps as were necessary to achieve this but that any question of a closure of one of the five main integrated steelworks would have to be considered in conjunction with the Government.

4 The recent BSC management decisions involving closures and redundancies illustrate the scale of the problem and the immediate measures necessary to stem the losses. In preparing their new Corporate Plan for the 3 years 1983/86, the BSC Chairman Mr Ian MacGregor has been discussing with me the further options open to him including the option that one of BSC's five major integrated steelworks might be closed.

5 In considering the future of these five works, the crucial question is how much capacity is likely to be needed in the foreseeable future. Compared with a manned liquid steel capacity last year, 1981/82, of 14.4 million tonnes a year, BSC's current output is running at a rate of below 10 million tonnes of liquid steel a year. If there were no prospect of any increased output, there could be no economic justification for retaining all five integrated steelworks.

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6        However, the position is not as bleak as that. There are a number of factors which should result in some increase in BSC's steel production in 1983 and this is indeed the Corporation's latest forecast. How far demand is likely to recover beyond that is of course difficult to predict. Much depends on external factors, notably the success of the ECSC steel regime, the future trends of world trade, and perhaps above all the international competitiveness of the main steel-using industries in Britain and of British Steel itself. The Government believe it would be wrong to take irrevocable decisions on future steel capacity at a time of such major uncertainty. Moreover, as I have made clear to the House on many occasions, the UK steel industry has made far greater cuts in capacity than the steel industries in other European Community countries. It is now the turn of other Member States to close steelworks and cut back capacity as we have done.

7        At the same time, I must make it clear that it remains the Government's firm resolve that the Corporation should return



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to lasting viability, free of Government subsidy. This is the only way to have an efficient steel industry, providing steel at competitive prices to the market and the only way to achieve secure employment in steel. Moreover, the Community steel regime requires operating subsidies to be eliminated by the end of 1984. Although it will not now be possible for BSC to become profitable this year as had been hoped, the Corporation have accepted that their aim should be to return to breakeven before interest in 1984/5.

8 The problem therefore is how to *what is to be done*  
*do it, would be to have a* ~~reconcile these conflicting~~ financial and commercial objectives. *in the longer term.*

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9 The Government have concluded that it would be right to ask BSC to prepare their Plan for 1983/1986 based on continuing steelmaking at all five major integrated sites. I must, however, make it clear that this does not imply that they will be required to maintain manned capacity at the current level of 14.4 million tonnes. Nor does it mean that all the facilities within each of the five major integrated sites will necessarily remain in operation - that will depend upon the future path of demand and output. Moreover, the Corporation

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will continue to be free to take management action to cut costs where necessary in order to maintain efficient operations and to move steadily towards the objective of viability.

10 There is also the question of future major investment. The Port Talbot hot strip mill is now 30 years old and in need of modernisation. (A project proposal has been put forward by the BSC which would cost some £175 million and take 3 years to complete.) The Government fully appreciates that it is important that the mill should operate to the highest standards of quality and efficiency and has therefore instructed the Corporation to prepare a considered case based on the up-to-date estimates of demand for the product. The project would also need the approval of the Commission. I would hope to be in a position to announce the Government's decision when I report to the House on the BSC's Corporate Plan.

11 The House will wish to know what the financial consequences of these decisions might be. Our preliminary view is that the additional costs can be contained within revised EFLs for this year and for 1983/4, which will nonetheless maintain the downward

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path of Government funding of the Corporation, albeit at a slower rate than we had previously envisaged, reflecting the inevitably slower progress to breakeven that we now expect. Until BSC have completed their new Corporate Plan, which I expect to receive early in the New Year, and until the Government have taken decisions on it and on the Port Talbot hot strip mill project, I cannot be more specific. I shall announce revised EFLs for this year and 1983/4 when the Government have taken these further decisions.

12 I must however stress one point. The decisions which I have announced today do not mean that any particular plant is safe. Although immense strides have been made over the last 2 or 3 years to raise productivity to levels approaching the best European standards, Mr MacGregor has made it clear to me that there is still quite a long way to go before BSC reaches levels of output per head comparable with its major competitors. There has, in recent years, been massive investment in modern plant by the Corporation amounting over £3000 million over the last 10 years. There is no reason why, given continuing efforts by management and workforce, the highest levels of quality, efficiency and service should not

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be reached. The decision to retain <sup>2</sup>  
steelmaking at the five major integrated  
sites <sup>1</sup> is a challenge both to management and  
men.

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