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10 DOWNING STREET

Prime Minister ④

This note sets out some of the problems ahead on steel.

Before calling for collective discussion of BSC you might want to consult Mr Tebbit on the tactics.

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PRIME MINISTER

3 July 1984

c Mr Redwood

BRITISH STEEL

John Redwood suggested I send you some condensed background information on BSC following Mr Tebbit's forewarning of serious problems at E(A) this morning.

1. Finance

Since the first full year of your first administration, BSC has had nearly £3 billion:

£1119 million	in 1980/81
£766 million	in 1981/82
£568 million	in 1982/83
£321 million	in 1983/84
£2774 million	

The EFL for 1984/85 is £275 million, but an overshoot seems certain.

Mr Lamont is at this moment seeking approval to raise BSC's borrowing ceiling from £3 billion to £3.5 billion - a figure which would be closer to £7 billion but for capital write-offs of over £3.5 billion provided by the Iron and Steel Act 1982.

All this seems light years away from the Government's requirement for BSC to break even before interest in 1984/85 and from the EC's directive that state aids to steel making should end by 31 December 1985.

2. Operations

The billions of pounds poured in have bought neither a viable BSC nor secure employment. Since its formation in 1967, BSC has cut back its work force from over a quarter of a million to 70,000. In the late 1960s it was producing around 25 million tonnes of liquid steel annually; last year it produced 12 million.

Down the years, when demand was strong, BSC hung on to high cost capacity. When demand was weak, it shed too little.

Capital investment was either misapplied or failed to bring in productivity or other cost gains. Ian MacGregor in 1980 inherited a lower output of crude steel per man year than was the case 1970. So, despite steady retrenchment, BSC:

i. is still saddled with far too much capacity;

ii. sustains its 50% share of the UK market on the back of a European cartel;

iii. is in regular conflict with private sector steel finishers.

Putting aside the fact that the state should not be engaged in steel making anyway, there is no case - strategic, economic or social - for preserving a British Steel industry bigger than the market requires.

The main task is to remove the burden of BSC upon the wider economy. Ministers and others may protest that an objective like that is financially sound, but "politically unwise". Not so. For this government, and particularly in this case, political and financial aims are entirely synonymous. The problems are presentational.

3. BSC's proposed objectives

BSC have tabled 'draft objectives' for the five years to 1988/89. Their document is short on market assessment, but robust on capacity. It takes the five main steel making plants - Ravenscraig, Llanwern and Port Talbot in the Strip Products Group, and Redcar and Scunthorpe in the General Steels Group - as a proxy for total capacity; and evaluates in profit and cash terms the effects of keeping all five open, then of going from five to four and from four to three.

There are two nasty twists to the evaluation. One is BSC's desire to buy up a private sector steel maker, Alphasteel in Newport, to take on its EC quota, and then close it. On the face of it, this looks indefensible - at a cost of £100 million, too. The second - easier to defend but appalling to contemplate - is BSC's intent to buy out its share of a Canadian iron ore pelletizing operation (Firelake) for £140 million.

The profit profiles vary widely, but none of the options is attractive in cash terms:

£ million 1984/5 to 1988/9	Profit (loss) after Int.	Cash Outflow
1. As now	(193)	1052
2. As now but close Alphasteel	198	930
3. Close Ravenscraig, close Alphasteel	435	795
4. Close Ravenscraig, but Alphasteel open	195	905
5. Close Ravenscraig, and one other BSC plant, but Alphasteel open	230/290	820/950

The main differences between the profit projections and the cash outflows are capital expenditure, increases in working capital (!) and exceptional items such as Firelake and Alphasteel.

The BSC Board under Bob Haslam are unanimous in their view that BSC must proceed quickly to four plants, and not obstruct the possibility of going to three thereafter. They also insist that Ravenscraig must be the first of any plants to close. The second plant closure is for debate: either Llanwern or one of the General Steels plants.

4. A Policy Unit view

BSC's proposals are indeed sensitive, but we see every reason for Ministers to be aware of BSC's thinking while the coal dispute is on. So we recommend that Mr Tebbit should brief you, and/or a meeting of Ministers in the near future.

There are some searching questions to be asked:

i. can BSC give you a better account of their expensive thinking on Alphasteel and Firelake? In particular, why won't Alphasteel close by itself if it is heavily loss making?

ii. what more can BSC do to improve their cash performance? Is the price of plant closure extravagant investment in the others?

iii. what are the implications of a three plant BSC with Alphasteel closing itself?

iv. is the cost to BSC of the coal dispute really £5 million per week? That is nearly as large as the whole EFL for the year.

In any evaluation, we recommend you to stick to the same firm financial line that you took at E(A) this morning.

The coal dispute does not alter fundamental truths about steel making. At worst it may complicate presentation. The future of coal, despite the lawlessness of the dispute and Scargill's attempts to turn it into a "political" fight, is a straightforward commercial matter. The NCB (and Government) are on strongest ground when they stick to presenting the commercial realities. Exactly the same applies to steel.

R.Y.

ROBERT YOUNG

Steel