

PRIME MINISTER

BSC Strategy
E(A) (85)45 & 50

BACKGROUND

E(A) will be resuming discussion of the proposal in the Secretary of State for Trade and Industry's paper (E(A) (85)45) on the strategy to be pursued by the British Steel Corporation (BSC). The meeting will also have before it a Note by Officials which responds to the Sub-Committee's request for further information on BSC's financial prospects, and on the possible implications of alternative strategies for the future of Ravenscraig.

MAIN ISSUES

FLAG A

2. The main issues, and the questions to be settled, remain as set out in the Cabinet Office brief for last week's discussion.

BSC Cash Flow in 1986/87

FLAG B

3. The Note by Officials explains the reasons for the change between the picture as presented in Mr Tebbit's letter to Mr Lawson of 12 June and that set out in Mr Tebbit's Paper. Essentially the change reflects the changed timing of BSC's payments for the purchase of the Alphasteel hot strip mill.

Alphasteel

4. Officials considered whether there could be advantage to BSC in not going ahead with the Alphasteel purchase, which would reduce BSC's requirements for cash this year and next. They have also considered whether any steps could reasonably now be taken which would assure the long-term future of steel-making at Ravenscraig. Two specific new Options have been examined:



(i) New Option A, under which the Alphasteel deal does not go ahead, there is no investment in concasters at Llanwern, and Llanwern becomes the 'swing' steel producer, with Ravenscraig fully utilised.

(ii) New Option B, under which the Alphasteel purchase and closure, and the transfer of concasters to Llanwern, go ahead, but instead of closing Ravenscraig completely only the hot strip that is closed in 1988, with a substantial level of steel production being retained there.

5. A financial projection is shown of the two new Options, compared with the base case, the previous Option 1 (closure of Alphasteel) and the previous Option 2 (closure of Alphasteel and complete closure of Ravenscraig). The following points are relevant to a decision:

(i) Both the new Options require the closure of the Ravenscraig hot strip mill. In the case of Option A, under which Alphasteel continues in independent operation, the impending closure would become public knowledge in the near future.

(ii) If Alphasteel continued in operation, BSC would nevertheless want to install concasters at Llanwern, whatever the future of steel-making at Ravenscraig. In BSC's view concasters represent a good investment, and failure to install at Llanwern would severely handicap the future operation of the works there. (The reasons why BSC consider Ravenscraig a much stronger candidate for closure than Llanwern are set out at Annex 2 to the Report on BSC Strategy attached to Mr Tebbit's paper.)



(iii) A final decision is not required in the near future on the closure of the Ravenscraig hot strip mill, or on the closure of that works as a whole.

Although it is impossible to foresee a long-term future for the strip mill, there is a real prospect of keeping steel-making going there after 1988.

(iv) The projections rely on BSC's analysis of the future market, and on the Corporation's financial model of their business. There remains a serious risk of prices weakening when and if EC quota controls are removed, and this could result in a far worse financial performance by BSC than any of the projections discussed in these papers.

(v) The continued independent operation of Alphasteel puts downward pressure on prices and tends to weaken BSC's market position. If there were a clear prospect of the Ravenscraig hot strip mill closing, while present quotas or something like them remained, there would be a prospect of BSC securing Alphasteel on better terms than are currently available. But if quotas were lifted, the threat represented by Alphasteel would be much greater, and it would be more difficult for BSC to buy out the company's strip-milling operations.

Ravenscraig

6. Officials have not found a complete solution to the Scottish Secretary's political problem. The only way to give a clear guarantee to the long-term future of the works seems to be to run-down Llanwern, which would simply transfer the political problem to Wales while seriously damaging BSC's business. It appears, however, that there is a real prospect of steel-making continuing at Ravenscraig after 1988 even though the hot strip mill would almost certainly have to close (as well as the Gartcosh cold rolling mill from whose closure in a few months time there has been no dissent).



Coke Ovens

7. Replacement of the existing coke ovens at Ravenscraig is not a necessary condition for the continuation of steel-making there. For the reasons explained in the Note by Officials, there is no economic case for spending £90 million on total replacement of the Ravenscraig ovens; and it seems very doubtful whether some much more limited investment would carry conviction without specific assurances being given on the future of the works as a whole. If assurances were to be given, it would be better to avoid compounding the problem by unnecessary investment expenditure on the coke ovens there.

Phoenix II

8. The Sub-Committee were inclined at last week's discussion to approve Mr Tebbit's proposals, subject to further appraisal of the costs in terms of the joint venture arrangement. The Welsh Secretary was concerned that this would imply the eventual closure of the GKN Brymbo plant at Wrexham; but he did not contest the point that this plant has no long-term future, since it could not be developed through the installation of new bloom casting facilities to take the place of the BSC Aldwarke plant. Although the Chief Secretary, Treasury did not specifically object to the additional requirement for cash in 1986/87 which the terms of the joint venture would require BSC to provide, it is possible that he might seek to reopen the issue on this occasion in the light of the overall position on the nationalised industries' investment and financing review. It is very doubtful whether a satisfactory alternative is available to the joint venture in its present form; failure to go ahead could result in BSC either having to undertake more expensive investment entirely on their own account, or in eventual total closure of UK capacity to produce engineering steels. It may be sufficient to agree the joint venture in principle, and leave the Treasury to discuss with the DTI in the context of the IFR the best way of minimising its financing costs, in the light of the further appraisal of the costs and terms of the deal.



HANDLING

9. You may wish to invite the Secretary of State for Trade and Industry to comment on the new material presented in the Note by Officials; the Secretary of State for Scotland will wish to assess the implications for Ravenscraig, and the Secretary of State for Wales will wish to make his position clear. The Chief Secretary, Treasury may wish to state his view point. Other Ministers may wish to comment on the political aspects of these decisions, and notably on the future of Ravenscraig.

CONCLUSIONS

10. Given that the Alphasteel question must be settled by 2 August, it remains desirable for the Sub-Committee to reach firm conclusions on

(i) Whether or not BSC should acquire and close in 1985 the Greek-owned Alphasteel strip steel mill subject to necessary assurances from the Commission on the acceptability of a Corporate Plan providing for retention of all BSC's present integrated steelworks.

(ii) Whether the two Alphasteel casters should be installed at BSC's Llanwern steelworks, and a second reheat furnace be installed at Port Talbot.

(iii) Whether BSC should close the Gartcosh cold rolling mill.

(iv) Whether or not to agree in principle that BSC and GKN should undertake the Phoenix II joint venture in engineering steels, subject to satisfactory further appraisal of the costs and the terms of the deal, and the prospects for the proposed new company.

JW

A J WIGGINS
Cabinet Office.