

CABINET

MINISTERIAL COMMITTEE ON ECONOMIC STRATEGY

MINUTES of a Meeting held at
10 Downing Street on
TUESDAY 15 DECEMBER 1981 at 12.00 NOON

PRESENT

The Rt Hon Margaret Thatcher MP
Prime Minister

The Rt Hon William Whitelaw MP
Secretary of State for the
Home Department

The Rt Hon Sir Geoffrey Howe QC MP
Chancellor of the Exchequer

The Rt Hon Sir Keith Joseph MP
Secretary of State for
Education and Science

The Rt Hon Michael Heseltine MP
Secretary of State for the
Environment

The Rt Hon Patrick Jenkin MP
Secretary of State for Industry

The Rt Hon John Biffen MP
Secretary of State for Trade

The Rt Hon Leon Brittan QC MP
Chief Secretary, Treasury

The Rt Hon Nigel Lawson MP
Secretary of State for Energy

The Rt Hon Cecil Parkinson MP
Paymaster General

THE FOLLOWING WERE ALSO PRESENT

The Rt Hon George Younger MP
Secretary of State for Scotland

The Rt Hon Nicholas Edwards MP
Secretary of State for Wales

The Rt Hon Lord Mackay of Clashfern QC
Lord Advocate
(Item 1)

The Rt Hon Michael Alison MP
Minister of State, Department
of Employment
(Item 1)

Mr J R Ibbs
Central Policy Review Staff

SECRETARIAT
Sir Robert Armstrong
Mr P L Gregson
Mr D J Bostock

CONFIDENTIAL

CONTENTS

Item No

Subject

1	BRITISH ALUMINIUM COMPANY LIMITED
2	BRITISH STEEL CORPORATION

Page

1

5

CONFIDENTIAL

CONFIDENTIAL

CONFIDENTIAL

1. BRITISH ALUMINIUM COMPANY LIMITED (BACo)

The Committee had before them minutes of 10 December by the Secretary of State for Industry and 14 December by the Secretary of State for Scotland; and memoranda by the Parliamentary Under-Secretary of State, Department of Industry (E(EA)(81) 43) and the Secretary of State for Scotland (E(EA)(81) 45).

THE SECRETARY OF STATE FOR INDUSTRY said that urgent decisions were necessary about the future of the aluminium smelter which BACo had set up in 1968 at Invergordon in response to the then Government's efforts to encourage aluminium smelting in the United Kingdom, and in the expectation that their energy costs would be comparable to those paid by smelters in other countries which were able to use cheap hydro-electric power. Invergordon's electricity prices were now three times those paid by BACo's overseas competitors; the market for aluminium was very depressed; the smelter was likely to make an operating loss in 1981 of about £20 million; BACo would close Invergordon unless it received a subsidy. If Invergordon were closed its electricity contract with the North of Scotland Hydro Electric Board (NSHEB) would need to be terminated. BACo had paid 20 per cent of the capital cost of Hunterston B nuclear power station; and was entitled to a "net residual value" equal to the value of the output from its share of Hunterston B less certain debts to the NSHEB. The amount of the "net residual value" had not been agreed. There were three issues for decision: should the Government let the smelter close; on what basis should BACo's contract with NSHEB be settled; and what special measures should be taken to alleviate the impact of the closure on the Invergordon area. The Government must reach decisions within a very few days, to permit BACo and the Scottish Electricity Boards to settle the matters at issue between them by 31 December 1981. BACo could be held to be acting illegally if it continued to trade beyond the end of the year because of the NSHEB's claims against it; in addition a settlement in 1982 rather than 1981 could well involve an insupportable tax charge on BACo. When the Sub-Committee on Economic Affairs (E(EA)) had discussed Invergordon, it had been generally accepted that the smelter's closure was inevitable (E(EA)(81) 16th Meeting, Item 1). E(EA) had therefore concentrated its

CONFIDENTIAL

attention on the terms of the settlement between BACo and NSHEB and the question of special assistance to the Invergordon region. The Sub-Committee had provisionally agreed that special assistance should be given. E(EA) had considered alternative bases for a settlement between BACo and the NSHEB: a payment of £30 million by the NSHEB, which would equal the cost of redundancies at Invergordon plus the value put on the smelter in BACo's balance sheet; and no cash payment between the company and the Board; the Sub-Committee had not however reached agreement on this question.

THE SECRETARY OF STATE FOR SCOTLAND said that, since E(EA) had discussed the Invergordon smelter, he had discussed with the Chairman and Managing Director of BACo the terms on which the company might be willing to continue its operations in Invergordon: these were set out in Amer A to his minute of 14 December. Over the next three years it would appear to be slightly cheaper to keep the smelter open than to close it, even if closure did not involve a £30 million payment by the NSHEB to BACo. Politically, it would be far better to keep the smelter in operation than to let it close, with grave consequences for the economy of the Scottish Highlands. The Government would be especially severely criticised if it allowed Invergordon to be shut and it was subsequently discovered that, in the short run at least, it would have been cheaper to keep it open.

The following were the main points made in discussion -

a. If a subsidy were paid to keep the Invergordon smelter open it would be difficult to avoid providing similar support to Alcan and Anglesey Aluminium, if this were needed. Alcan's smelter at Lynemouth, Northumberland was already running at a loss. Anglesey Aluminium was profitable at the moment, partly because until Dungeness B power station came into operation in 1982 or 1983 it would continue to pay its original contract price for electricity; when the power station came into operation, the electricity cost would be doubled. Subsidising BACo's electricity would also make it more difficult for the Government to resist demands from other industries for compensation for high United Kingdom energy prices.

b. Further work needed to be done on comparing the costs of closing Invergordon and keeping the smelter open. It was not clear that it was appropriate to count as part of the costs of closure a loss of revenue to the National Coal Board; it should also be assumed that special assistance in the Invergordon area would be comparable, in terms of cost per job lost, to the support which the Government had given to other areas severely hit by closures, such as Shotton.

c. BACo had indicated that they would not be willing to keep Invergordon open without a guarantee that future increases in electricity prices would not exceed the general rate of inflation in any year. It had been put to the company that this was an unreasonable assurance for them to seek from the Government: energy prices were affected by various developments outside the Government's control and had tended to run ahead of inflation generally. The company had replied that they could not regard Invergordon as a viable operation without some assurance about future electricity costs.

d. Although the economic arguments for keeping the smelter in operation were weak, there were special problems in the North of Scotland. The scope for providing new employment in the Invergordon area on the scale required was very limited. The smelter had acquired symbolic significance as a major new industrial investment and its closure would have widespread and devastating effects on confidence in the Highlands.

THE PRIME MINISTER, summing up the discussion, said that it was provisionally agreed that the right course would be to try and find an acceptable and defensible basis on which the Invergordon smelter could be kept in operation for at least a further three years or so. The Government could not however agree to the company's request for a guarantee that future escalation of electricity costs would not exceed the general rate of inflation; any commitment about electricity prices would have to be limited rather than open-ended, although there might be some provision for a review. The

arrangements negotiated with the company would have to be such as to minimise the risk of further requests for assistance either in respect of the other two aluminium smelters or from other industries, taking account also of the Community implications. It would be necessary to assess the costs of continued operation in comparison with the costs of closure as reliably and realistically as possible, taking account of all relevant factors, so that the Government would in due course be able to justify the decision taken. A group of officials, led by the Head of the Central Policy Review Staff, would need to explore these matters urgently and report back to a small group of Ministers, under her chairmanship, before the end of the week; final approval would then be given to the terms on which a settlement, preferably providing for the continued operation of the smelter, would be reached with the company before 31 December 1981.

The Committee -

1. Took note, that the Prime Minister would arrange for a group of officials, led by the Head of the Central Policy Review Staff, to explore urgently whether an acceptable and defensible basis could be found for keeping the Invergordon smelter in operation, taking account of the points made in the Prime Minister's summing up, and to report before the end of the week.

2. Agreed that the final decision on the terms of a settlement with the British Aluminium Company Limited would be taken by the Prime Minister in consultation with the Secretaries of State for Scotland, Wales, Industry and Energy and the Chief Secretary, Treasury, in the light of the report by officials.

2. BRITISH STEEL CORPORATION

The Committee had before them minutes of 11 and 14 December by the Secretary of State for Industry relating to a proposal by the British Steel Corporation. Their discussion and conclusions are recorded separately.

Cabinet Office

16 December 1981

SECRET

THIS DOCUMENT IS THE PROPERTY OF HER BRITANNIC MAJESTY'S GOVERNMENT

COPY NO 27

CABINET

MINISTERIAL COMMITTEE ON ECONOMIC STRATEGY

LIMITED CIRCULATION ANNEX

E(81) 39th Meeting Minutes, Item 2
TUESDAY 15 DECEMBER 1981 at 12.00 Noon

BRITISH STEEL CORPORATION

SECRET

The Committee discussed the possible acquisition by the British Steel Corporation (BSC) of a United States Steel Company, Kaiser Steel Inc. They had before them minutes of 11 and 14 December by the Secretary of State for Industry.

THE SECRETARY OF STATE FOR INDUSTRY said that the Chairman of BSC had proposed that the Corporation should acquire Kaiser Steel, a Californian steel works whose main products were very similar to those of the BSC strip products group. The Company were phasing out the production of liquid steel, principally because of costs imposed by environmental control regulations and in future would buy in steel slabs. BSC were already planning to supply Kaiser with 150,000 tonnes of steel slab in 1982-85: if the Corporation bought Kaiser it would obtain an assured outlet for about 1.5 million tonnes a year by 1984, which would help secure the future of the integrated steel strip mills at Port Talbot, Llanwern and Ravenscraig, reduce the scale of redundancies currently planned and help BSC's profits. Kaiser had good prospects of obtaining substantial orders for pipelines in North America. The cost of buying Kaiser steel would be about £200 million (\$400 million). Half of this sum could be raised in the banking sector and outside the public sector borrowing requirement. The Government would need to provide or guarantee the other £100 million. It was likely that at least £50 million of this could be repaid immediately after the acquisition of Kaiser from the company's substantial cash resources (a device which United States law permitted). BSC believed that they could find most of the remaining £50 million from within their existing 1981-82 external financing limit. He proposed to circulate a fuller report on this proposal within the next day or so. 1. Immediately, he invited the Committee to

SECRET

203

agree that he should authorise the Chairman of BSC, who was in the United States, to offer to purchase the 17 per cent of Kaiser Steel owned by the Kaiser Foundation at a price of \$55 per share (with freedom to increase this to \$60 if necessary) on 16 December; and to take an option on 22 per cent of shares of Kaiser Steel owned by Wall Street institutions. These moves would not pre-empt the Government's decision on whether to allow the BSC to purchase 100 per cent of Kaiser Steel; failure to act quickly might however jeopardise the entire project.

The following were the main points made in discussion -

a. If BSC were in the private sector there would be much to be said for its buying Kaiser Steel: the rewards could be very great. On the other hand the risks were considerable. It appeared that BSC could only meet part of the costs of acquisition from Kaiser's cash holdings if it obtained 100 per cent of the shares; BSC might be locked in with a minority which would block its efforts to exploit the benefits of the takeover. Kaiser's profitability depended on the United States Government's continuing to prevent imports of cheap Asian steel products. It would also be expensive to disengage from Kaiser Steel if the venture was unsuccessful; on liquidation the company might have pension and health insurance liabilities amounting to over \$500 million: as a result Kaiser was attractive only to a buyer willing to continue the company's downstream operations, and not to asset strippers; this was why BSC could buy it comparatively cheaply.

b. It was not clear that it was right for BSC, as a nationalised industry backed by the Government, to undertake this potentially risky transaction. Certainly it would be imprudent for the Government to agree to its purchase without independent advice about the financial implications of the Secretary of State's proposal and about the legality of the way in which it was intended to apply Kaiser's own liquid assets to meeting the cost of purchasing the company. There might be political pressure in the United States to prevent a takeover by BSC, and possibly to restrict the importation of BSC's steel slab.

c. If Kaiser was such a good investment prospect it might be possible to find a private sector purchaser who would take it over on the terms proposed for acquisition by BSC. On the other hand it was doubtful whether a private sector company would commit itself to purchase BSC's steel slab.

d. Buying Kaiser could not guarantee the prospects of Llanwern, Port Talbot and Ravenscraig against the effects of, for example, excessive BSC production costs or decisions by the United States Administration which could affect steel prices unfavourably.

e. Taking responsibility for a United States company such as Kaiser would add considerably to BSC's management burdens. United States experience was needed and this would present difficulties for Mr Ian MacGregor's eventual successor as Chairman of BSC.

f. It would be difficult to justify publicly a decision to allow BSC to purchase Kaiser: it looked like a measure to increase the scale of a state industry's operations. On the other hand, a successful link with Kaiser might eventually make BSC more attractive to private sector capital; and it might be equally difficult to justify refusing to let BSC pursue an attractive commercial opportunity which could bring benefits to Scotland and South Wales.

THE PRIME MINISTER, summing up the discussion, said that the Committee recognised that the proposal made by the Chairman of BSC appeared, at first sight, to be financially attractive and to offer useful additional outlets for the products of the three strip mills. It would not however be easy to reconcile the acquisition of a steel company in the United States with the Government's policy of reducing the public sector. Although the purchase of the shareholding held by the Kaiser Foundation and the option on the shares held by institutions did not commit the Government to approving the complete acquisition of Kaiser Steel, these developments would immediately attract strong public and political interest. It would be unwise to allow these preliminary

moves to be made unless the Government had sufficient confidence in the merits of the takeover. There were however some major risks which needed to be assessed expertly and in some depth, for example the possibility of litigation in the United States which might prevent the expected benefits from being realised, the danger of competition from Asian steel imports or of measures to restrict United Kingdom imports, and the extent of the liability which might be incurred if Kaiser Steel had to be liquidated. The Secretary of State for Industry should, in consultation with the Head of the Central Policy Review Staff, seek independent advice urgently on these matters from a United States merchant bank and from United States lawyers, and report back to the Ministers most closely concerned. Meanwhile the Chairman of the BSC would have to be told that the Government was not yet in a position to approve the purchase of any shares in Kaiser Steel.

The Committee -

1. Invited the Secretary of State for Industry to seek independent expert advice urgently on the opportunities and risks involved in the acquisition of Kaiser Steel by the British Steel Corporation, in the light of the Prime Minister's summing up, and to report back to the Ministers most closely concerned.
2. Took note that the Prime Minister, in consultation with the Chancellor of the Exchequer, the Secretaries of State for Industry, Scotland and Wales and the Chief Secretary, Treasury would consider the matter further in the light of the expert advice.

Cabinet Office

16 December 1981