

PRIME MINISTER

BSC FUTURE STRATEGY

1. BSC's analysis is clearly correct. Even if UK demand for steel does revive faster than demand in the rest of ECSC, that extra demand can almost certainly be satisfied from domestic sources without one of BSC's five existing integrated steelworks. And the most obvious candidate for closure is Ravenscraig (which should never have been built in the first place).

2. The political pressures in Scotland not to close Ravenscraig need no emphasising. But there are British political pressures too, of a kind which Patrick Jenkin only hints at in paragraph 21(ii).

Resentment is growing all the time that the UK steel industry is suffering much the worst of surgery while other ECSC members are merely trimming at the margin. True, this contrast is so sharp largely because they were taking a sensible view of future steel demand and acting on it in the years when the Labour Government was Beswicking about. But if we closed another major strip mill before action on a similar scale was visible on the Continent, the Davignon regime would appear to be absurdly unfair.

3. We need to maintain our present capacity for the time being to secure a fair - and, if possible, an improved - slice of the total European market when demand returns to a path nearer its 1975-79 level. Otherwise, we should have surrendered in advance our bargaining position in the Brussels follow-up to the State Aids Decision.

To keep Ravenscraig open for the moment would be a sign of political resolution, not feebleness.

4. We recommend:

- (a) that you should accept Patrick Jenkin's option (ii);
- (b) the British Government should reinforce - and with maximum publicity - its demand that "other member states must make substantial permanent cuts in steel capacity in return for state aids, to match the action we have taken in the UK".



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To: PRIME MINISTER

3 December 1982

From: JOHN SPARROW

BSC Future Strategy

1. We are meeting on Monday to discuss the future strategy for BSC. I felt that it might be helpful to provide you with a note of the principal issues as I see them. This minute has not been copied to the other Ministers attending the meeting.
2. The commercial case for closing Ravenscraig immediately is over-whelming. The risks of losing some customers are relatively small and it is far from clear that immediate closure of Ravenscraig necessitates expenditure on continuous casting in South Wales before the mid-1980s. However, I recognise that decisions may not in this case be taken solely by commercial criteria.
3. If it is decided to endorse Patrick Jenkin's recommendations of option (ii), to agree that it is necessary to close an integrated works and defer the decision for 2/3 years, there will still be commercial risks. The customer preference for strip from Llanwern is very strong. BSC could finish up with the worst of all worlds: an inefficient Ravenscraig and a Llanwern no longer meeting customer preference and market needs because it does not have continuous casting. There is also considerable risk that customer confidence in the BSC strip business may be eroded if two plants are known to be at risk. Closing Llanwern will leave BSC with virtually no safety margin of capacity for hot rolled coil unless the market declines further. So in commercial terms, option (ii) ought in effect to be a decision to close Ravenscraig at the appropriate time.
4. These important short term decisions are made even more difficult by the absence of any long term strategic view of the business from the BSC Management. Immense sums of money are being proposed for investment

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over the next four or five years without any clear vision of the size and configuration of the business that will be required for the 1990s. A ten year view is needed. I endorse Patrick Jenkin's desire for a strategic review of General Steels, and, depending on the decisions taken, a revised long term view of the Strip business is essential.

5. If closure is deferred, there is also the question of what to do in the interim period to minimise the ultimate social effects of closure. Special measures should be taken now, and over the next year or two, to stimulate alternative employment opportunities in the Ravenscraig area.

6. It may also be appropriate to probe whether the expenditure on a new Hot Strip Mill at Port Talbot can really be justified at the present time. Certainly the investment will give Port Talbot the capability to produce the heavy coils that only Ravenscraig can presently produce, and there will be improvements in quality and efficiency; but the financial return seems marginal. However, if the expenditure is made, it makes closure of one of the other strip plants even more essential if the full benefit of the investment is to be realised.

7. On a point of presentation, I agree that if option (ii) is endorsed, a key factor will be the need to test the strength of Ian MacGregor's and the BSC senior managements' feelings before announcing the decision.

8. I am sending a copy of this minute to Sir Robert Armstrong only.

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Prime Minister

BSC FUTURE STRATEGY

I have grave doubts about the Secretary of State for Industry's minute dated 2 December.

The firm recommendation of BSC is that of the 3 integrated works in the strip mills group, Ravenscraig should be selected for closure. BSC identify a 'strong customer preference' for the quality and weight of the coil produced at Llanwern, coupled with a need to introduce continuous casting if that preference is to be maintained. Ravenscraig has substantially the highest costs and these reflect both the 'inherent high costs of the facility arising from its location (separate from its port), inefficient coke ovens and low capacity steel making vessels'. They refer to Ravenscraig's remoteness from its main domestic markets in the West Midlands. The cost performance figures for Ravenscraig continue to fail to match those of the plants in South Wales. As a result of the analysis BSC eliminated Llanwern 'from the possible closure list' and concluded that 'the candidate for closure taking into account product constraints, cost performance and prospective capital costs, should be Ravenscraig'. In addition it has to be noted that unless 'there is a significant further fall in demand for hot rolled coil' over current BSC forecasts, a closure of Llanwern rather than Ravenscraig (whether it took place now or in 2 to 3 years time) would leave BSC with no spare capacity.

In other words, the proposal is to overturn the commercial logic of Mr MacGregor's case and to put at risk the primary objective against which we have justified our massive funding of BSC so far: to produce a viable and competitive steel-making industry.

It is very clear that the case for deferring the closure of Ravenscraig is not commercial and financial but political. Though the reasons for putting forward a political solution to the problem are apparent, the particular proposal made by the Secretary of State for Industry appears potentially disastrous. Any decision to defer has the inherent danger of repeating the mistake of the Labour Government which, by

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delaying necessary decisions, made it inevitable that the eventual cut-back would be far more severe than it need have been - a mistake for which we have consistently and rightly criticised our predecessors. The key to the future is competitiveness. A decision to close Ravenscraig now and proceed with investment at both Port Talbot and Llanwern would mean that we would secure the future of two highly competitive plants. The Secretary of State for Industry is proposing not only that a plant with 'inherently high costs' should be maintained but that as a consequence we should close the door to the modernisation of Llanwern. The inevitable outcome must be that two or three years from now we would have two uncompetitive plants and would be faced with an even more difficult problem than we now face. The very arguments used in the Secretary of State's paper to support his case for investing in the essential hot strip mill at Port Talbot emphasise the destructive nature of what is envisaged for Llanwern.

It is absolutely clear from the paper that Llanwern would be put at risk not because there is any prospect of Ravenscraig overcoming its inherent weakness but because the political decision had been taken to starve Llanwern of investment.

While I fully appreciate the political case for deferring a decision at Ravenscraig, I cannot accept that this should lead to the slow emasculation of the plant that has secured both customer preference and better cost performance and productivity.

It is, I am afraid, untrue that the closure of Llanwern would have less serious social effects than the closure of Ravenscraig. Total job reductions in South Wales at between 10,000 and 13,000 might be involved, with the upper figure more likely. Newport would not be the only sufferer. The effect on the Gwent coking coalfield would also be severe since its main customer, Llanwern, would be gone. In the worst case up to 5,000 deep mining jobs might be lost. The Ebbw Vale travel to work area (still suffering from the effects of the steelworks closures of the 1970s) would almost certainly be hardest hit with the loss of over 2,000 jobs; unemployment would rise from 24.5% to 30% or more. Pit closures on this scale would cause serious political problems in South Wales and the financial consequences for the NCB could well be serious too.

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If closure of Ravenscraig is to be deferred, the decision should not be at the expense of Llanwern or the future competitiveness of BSC. We should find the cost of both keeping Ravenscraig (on whatever scale is judged appropriate) and of securing the continuing competitiveness of Llanwern in the long term. To do otherwise would be a grave industrial error. Yet again the efficiency of an industry would have been undermined by Government interference. The Scottish political problem would have been resolved by transferring it to Wales. In my judgement there will be no way of defending such a decision in economic or commercial terms. It will be well known that we have completely overturned the commercial judgement of the man we recruited to bring BSC into better shape, whose efforts to date have been largely vindicated by performance on the ground in adverse market conditions. What is happening will be obvious to all. The position of Welsh Office Ministers and Government supporters in Wales will be seriously undermined. The decision would be seen as a major defeat in which Wales and indeed the future of the Steel industry have been sacrificed to save the Conservative Party in Scotland.

I am sending a copy of this minute to the Chancellor of the Exchequer, the Secretaries of State for Industry, Scotland, Employment and Trade, the Secretary of the Cabinet and the CPRS.

L.D.

3 December 1982

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approved by the Secretary of State and signed in his absence.

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PRIME MINISTER

British Steel Corporation Future Strategy

BACKGROUND

You are holding a meeting with the Ministers most closely concerned at 10.00 am on Monday 6 December to discuss the future strategy of the British Steel Corporation (BSC). In preparation for that meeting the Secretary of State for Industry has circulated, with his minute of 2 December, a paper describing the current outlook and making proposals for action.

2. Mainly because of a decline in the world market for steel and a reduction in BSC's share of the market, BSC's financial prospects have worsened severely. Losses are running at about £7 million a week; the expected total loss in 1982-83 is about £200 million before interest (£200 million worse than plan); if no offsetting action is taken the forecast loss for 1983-84 is £380 million (over £400 million worse than plan). A number of measures to reduce costs are in hand; but the BSC consider that they cannot achieve lasting profitability without closing one of their five integrated steel works. In particular, they think they will need to close one of the three hot strip mills (at Ravenscraig, Port Talbot, and Llanwern); and that if closure takes place quickly it should be at Ravenscraig.

3. The Secretary of State for Industry suggests that the Government must maintain its objective that the BSC should be profitable without Government subsidy and should eventually be restored to the private sector. Unless the Government expects a large, early and substantial upturn in the demand for steel (and there is no reason to do so), this entails closure of a major integrated works. He considers four options:

- (i) close Ravenscraig as soon as possible;
- (ii) decide to close a strip mill, but defer the choice of works for two or three years;



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- (iii) an early partial closure in the Ravenscraig complex, with the implication that Ravenscraig has no long term future;
- (iv) deferring the question of closure altogether.

He recommends option ii.

4. The Secretary of State also advocates a decision in principle in favour of BSC's proposals for modernising the hot strip mill at Port Talbot, costing some £175 million. He recognises that, among other things, this will create difficulties with the European Commission (who would not approve substantial new investment in current circumstances of excess capacity unless accompanied by a reduction in capacity elsewhere). But he suggests that they could be solved by a 'contract to limit output'

5. The Secretary of State also makes proposals on presentation, and suggests that he should circulate the draft of a Parliamentary statement reflecting the Government's decisions.

MAIN ISSUES

6. The main issues for the meeting are as follows.
- (i) Is the closure of a major integrated steel works necessary?
 - (ii) If so, which should it be?
 - (iii) Should the proposed investment at Port Talbot be approved?
 - (iv) How should relations with the Commission be handled?
 - (v) How should the Government decisions be announced?

Is closure necessary?

7. To decide not to close any of the large integrated steel works would be tantamount to accepting that the BSC will not be profitable for the foreseeable future. This would be a complete reversal of existing policy. A closure therefore seems inescapable sooner or later. It is relevant that the short-term forecasts in the paper seem more likely to be optimistic than pessimistic.



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They assume, for example, that BSC will secure 50 per cent of the UK market (compared with their present share of 48 per cent) and exports at the same level as in the current year, despite the weakening of the world market and the restrictions on imports imposed by the USA.

Which works should be closed?

8. It seems inescapable that if closure is to be immediate it should take place at Ravenscraig: the BSC assessment in Annex 2 to the paper points unambiguously in that direction. But the Secretary of State argues that closure should be deferred for two or three years. The choice of works would then also be deferred, since it is possible that performance at Ravenscraig would improve enough to make it preferable to close Llanwern. Unemployment there, though high, is lower than at Ravenscraig; and existing consumer preference for Llanwern is expected to decline because Llanwern cannot, without substantial new investment, produce continuously cast feed stock. The decision therefore turns on timing.

9. The Secretary of State for Industry advances some powerful arguments for delay.

(i) It would strengthen our hand in demanding reductions in steel-making capacity from our European partners.

(ii) Immediate closure of Ravenscraig would produce very high unemployment in the area - about 30 per cent male unemployment, after allowing for consequential effects of closure.

(iii) It would avoid some (probably fairly small) loss of markets to imported steel.

(iv) It would at least postpone the need for £100 million investment in continuous casting facilities in South Wales: customer preference is for continuously cast feedstock, which Ravenscraig produces but Llanwern does not.

But there are also arguments on the other side, which you will want the meeting to explore.



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(v) Delay may jeopardise the necessary improvement in BSC's
finances.

(vi) It is also likely seriously to complicate negotiations
with the Commission.

10. Most importantly, it must be doubtful whether it would be possible to prevent it from becoming known that the Government and BSC expected a major closure in two or three years time. Apart from the usual risk of leaks, the Commission would be bound to press for an indication of our intention to reduce capacity, especially if they were being asked to approve the proposed new investment at Port Talbot. Other European countries would ask why the UK was being allowed to install substantial new capacity without making reductions elsewhere. If it were to become known that a major closure was in prospect, but no decision had been made between Ravenscraig and Llanwern, the Government would face very heavy pressure from both areas.

it would cast a blight upon both areas?

MCS

Proposed investment at Port Talbot

11. There is a strong case for further investment at Port Talbot. This is already the BSC's lowest-cost strip steel producer; but it will need to be kept up to date if it is to stay competitive on international markets. However, we understand that a fully worked out case has not yet been presented by the BSC; and there may well be questions about, for example, the exact timing of investment which need consideration. You may feel that the BSC should be invited to make out a proper case in the context of their corporate plan.

Relations with the European Commission

12. It is possible that there may be more difficulty with the Commission than the Secretary of State for Industry allows in paragraph 13 of his paper. It may be that they will insist on a public statement of intention to close a strip mill, not only as a condition for approving new investment at Port Talbot but also for approving further financial support. It cannot be taken for granted that the proposed 'contract' to limit output will be sufficient. No doubt it will be necessary to start confidential exploratory talks with the Commission as quickly as possible.



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Announcements

13. The Secretary of State for Industry outlines a possible Parliamentary statement in paragraph 21 of his paper. It reflects the arguments he puts forward about the substance of the decisions, and has the same strengths and weaknesses. As he points out, it risks creating political problems at both Ravenscraig and Llanwern. It is also not easy to see how it can avoid either:

(i) implying that the financial situation of the BSC is not particularly serious (an implication that would be strengthened if and when an announcement is made of further investment at Port Talbot); or

(ii) admitting that the situation is serious, but implying that the Government and the BSC are deferring necessary corrective action because the political consequences are unpalatable.

Other options

14. If other Ministers are doubtful whether the Secretary of State for Industry's option (ii) will work, because of the uncertainty which may be cast over both Ravenscraig and Llanwern, and are nevertheless reluctant to face the immediate closure of Ravenscraig, they may wish to look more carefully at the two remaining options - either the partial closure of Ravenscraig (option (iii)), or deferring a closure decision altogether (option (iv)). In either case it might be necessary to defer also the Port Talbot modernisation, but it could be argued that the case for going ahead with that substantial new investment in the near future has not yet been fully made out. Option (iii) would have the advantage that it would save some money (£15 million a year) and would enable the redundancies at Ravenscraig to be spread out over a longer period. Option (iv) is the least desirable option on economic and commercial grounds, but some Ministers may see political and social arguments in favour of it. They may point out that even under the Secretary of State for Industry's preferred option (ii), closure is to be deferred. Why therefore should the Government be forced into a decision now that one of the strip mills will definitely be closed?



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HANDLING

15. You will wish to ask the Secretary of State for Industry to introduce his paper. All the other Ministers present have a clear departmental interest and will no doubt want to contribute. Whatever the meeting may decide, the presentation of the decisions seems likely to be difficult; and you will wish to ensure that the meeting devotes sufficient attention to this aspect.

CONCLUSIONS

16. You will wish the meeting to reach conclusions on the following:

a. which of the following options should be adopted:

(i) immediate closure of Ravenscraig;

(ii) a decision to close one strip mill, with the choice deferred for 2 or 3 years;

(iii) early partial closure of Ravenscraig;

(iv) deferring a decision on closure altogether.

b. Should the proposed investment at Port Talbot be approved in principle?

c. How should relations with the Commission be handled?

d. How should the Government's decisions be announced?

17. Depending on the decisions reached, you will no doubt wish to invite the Secretary of State for Industry to circulate the draft of any statement. It is highly desirable that when he does so he should allow colleagues adequate time to consider the text: the presentation is almost certain to be very difficult.

PLG

P L GREGSON

3 December 1982

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PRIME MINISTER

BSC FUTURE STRATEGY

In the light of the marked worsening in BSC's position over the last few months, and the consequent possibility that the Corporation might have to close one of their five integrated works, it is necessary for the Government to give the Corporation guidance on the basic assumptions on which they should finalise their Corporate Plan for 1983-86.

2 I attach a paper describing the current outlook for the BSC and the guidance I believe we should give them. I should emphasise that since this paper has, by definition, been prepared before completion of the BSC Corporate Plan, all the financial information is necessarily provisional and is subject to revision when the Plan itself is finalised. The figures are, however, of the right order of magnitude.

3 I am sending copies to Geoffrey Howe, George Younger, Nicholas Edwards, Norman Tebbit, Arthur Cockfield, Sir Robert Armstrong and John Sparrow.

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2 December 1982

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BRITISH STEEL CORPORATION: FUTURE STRATEGY

Introduction

Since we discussed the British Steel Corporation (BSC) Plan for 1982/83 on 9 June (E(NI)82 5th meeting), there has been a marked worsening in BSC's performance. Since May, steel orders have been about 30 per cent below forecast, production has been cut, and losses are now running at about £7 million a week before interest, compared with a near breakeven position in March to May this year. The outlook is that BSC's losses, before interest, for 1982/83 will be about £200 million, whereas the target for the year was to achieve breakeven before interest.

2 This sharp deterioration is due to a combination of factors: BSC has lost market share to imports in the first half of the year, achieving only 48 per cent of the UK market during the period as against 52 per cent in their Plan. There has been a small decline in UK steel demand over this period and the outlook is for a more serious decline in the 6 months to March 1983. Most important of all, BSC export orders have dropped sharply, as we and BSC recognised might happen when we discussed the BSC Plan in June. This is due to weak international demand for steel, the direct and indirect effects of the US steel import restrictions, and (until very recently) the continued strength of the £ against the DM. An analysis of the changed steel market situation and outlook is at Annex 1.

3 The effect of this deterioration in BSC's performance and prospects for 1983/84, if no offsetting action were taken, is illustrated in the table below:

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BSC Sales and Financial Projections: 1982/85 Plan and Latest View

	1982/83		1983/84	
	Plan	Latest View	Plan	Latest View
Sales (million product tonnes)	11.5	<u>9.0</u>	11.9	10.0
Profit/(Loss) after interest and contingencies	(90)	(300)	40	(380)
Cash Requirements	365	500	200	600

Note: The loss projection for 1983/84 includes provision for a further cost/price squeeze which is estimated to increase BSC's losses by £180 million over the year unless offsetting action is taken.

BSC: Management Actions

4 BSC already have in operation a management action programme which is aimed at reducing manpower by over 15,000 by March 1984 and producing savings of £242 million in a full year, of which £180 million is estimated to arise in 1983/84. This programme has 3 elements:

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	Savings
i) manufacturing cost improvements, including improvements in yield and energy consumption	99
ii) <u>further reductions in manpower at all levels, to improve productivity.</u> This will involve about <u>9,200 job losses</u>	71
iii) closure of a number of smaller plants and works, involving about <u>6,000 job losses</u>	<u>72</u>
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A number of the "smaller" closures have already been announced, including Clydebridge Plate Mill, Craigneuk Bar Mill, Round Oak Steelworks and the former Duport London Works. Important announcements still to come in this category are the Ravenscraig "ingot route" slab mill, and the closure of the Hartlepool works.

5 The programme described above will not eliminate BSC's expected losses in 1983/84. In addition, therefore, BSC have set "new targets" for 1983/84 which are intended to ensure that further action is taken to offset in full the £180 million cost/price squeeze in 1983/84. Individual businesses in BSC are now preparing proposals to meet these new targets, but BSC have indicated that one element will probably be further manpower reductions, possibly of the order of 4,000 in 1983/84. In addition, the Corporation expect to oppose firmly any price increases sought by their suppliers, thereby reducing the cost/price squeeze. Action by the Government and the European Commission to sustain the ECSC price regime will also help.

6 The recent fall in the £ against the DM, although welcome to BSC, is not likely to alter the outlook significantly, since the BSC Plan for 1983/84 was already being drawn up on the basis that the average exchange rate during the year will be DM4.00 = £1.

7 BSC are also considering the introduction of new flexible manning arrangements of a much more radical nature than hitherto. These arrangements, sometimes referred to as the "steelworker concept", have been implemented at the Bromford works in BSC Tubes Division. They involve workers accepting flexible working on a wide range of duties across traditional process/craft, staff/manual and clerical/technical boundaries. Very substantial further productivity improvements are likely to

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result from widespread implementation of this concept, but at present BSC wish to avoid raising it at national level with the unions collectively: their tactics are to secure wider introduction at individual plants as part of local productivity bargaining.

8 The measures outlined above might just - if all goes well on the demand, price and efficiency aspects of the new Plan which BSC are developing, - get the Corporation back to a small profit after interest in 1984/85. But BSC's view is that they cannot achieve lasting profitability while retaining all 5 of their integrated steelworks at Ravenscraig, Port Talbot, Llanwern, Scunthorpe and Teesside. In particular, they say, the market will not support three hot strip mills at levels of output which will ensure economic working.

BSC: Closure Options

9 BSC have therefore carried out a review of their 5 integrated works. The results of this review are set out at Annex 2. Their firm recommendation is that one of the strip mills must eventually close, and that if the closure takes place quickly it should be Ravenscraig. I have said that the strategic question of a major works closure is for the Government, not for BSC alone, and it is for that reason that we need to give guidance to BSC in preparing their new Plan for 1983/86.

10 Our overriding policy objective has been that BSC should become profitable, free of Government subsidies, and that eventually it should be returned to the private sector. ECSC steel policy also requires that all state operating subsidies to steel enterprises must end by 1985. My first proposal is therefore that we reaffirm this objective. It is against that background that we need to consider the BSC recommendation that to be competitive one of their strip mills must close.

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11 I have identified 4 options:

(i) to agree to the BSC recommendation that Ravenscraig should close completely as soon as possible. This is the hard commercial option which BSC management would ideally prefer. Combined with the tough measures to cut costs described above, it would provide the quickest route back to profitability. Ravenscraig is currently the highest cost works of the 3 BSC strip mills and there is no long term need for its capacity.

(ii) to decide that a strip mill should close, but to defer the choice as to which works should be closed for 2 or 3 years. This option is discussed more fully below, but briefly the advantages over option (i) are first, that it postpones the need to invest in continuous casting capacity in South Wales at a cost of £100 million; second, that it gives Ravenscraig the chance to show that it can perform as well as or better than, say, Llanwern; and third that it could provide the best climate to force through the very tough demanning measures that are needed in any event. An immediate closure would also result in some loss of markets to imports, which this option would avoid.

(iii) to agree to an early partial closure at Ravenscraig/Gartcosh, with the clear implication that steel-making at Ravenscraig has no long-term future. This would be an interim solution involving, at a minimum, the closure of 1 blast furnace and the Gartcosh plant. (The ingot route slabbing mill will in any case close early next year.) Ravenscraig's continuous casting capability and the hot strip mill would be retained for the time being. This would enable the social consequences of the closure of Ravenscraig to be spread over a longer period, with remedial measures being put in hand well before the final closure. While there would be significant cost savings to BSC from this option, it would be difficult to claim that Ravenscraig

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had a long term future.

(iv) to instruct BSC to plan for a return to profitability by early 1984 but without the closure of a major integrated works. This would defer the questions of closure until the results of the new BSC Plan had been seen and assessed, and would involve no explicit acceptance by Government that a major works must close. It could only be justified if the Government believed that a large, unforeseen sustained upturn in steel demand would appear before 1985 which would enable the Corporation to earn a profit on its operations at all 5 integrated works. I see no grounds for such optimism.

12 In considering each of these options, we will need to take a view on BSC's proposals for modernising the hot strip mill at Port Talbot, at a cost of about £175 million. This project is intended to complete the modernisation of the whole Port Talbot steelworks, which is already BSC's lowest cost strip steel producer. The modernisation project, discussed in more detail at Annex 3, will enable the Port Talbot works to be an internationally competitive strip mill well into the 1990s.

13 We will also need to bear in mind the European dimension. This is discussed more fully in Annex 4. The essential point is that Government support for BSC will not be approved by the Commission unless it is matched by cuts in capacity. We have already made substantial cuts and a further £400 million tranche of support for 1982/83 was agreed by the Commission on 25 November. The further closures now being announced by BSC, including the closure of the Ravenscraig ingot route, will justify further support. The closure of an entire strip mill would almost certainly resolve all problems. There would be more difficulty if under any option other than option (i) we were to seek approval for the modernisation of the Port Talbot hot strip mill, because this would involve an increase in capacity unmatched by a reduction elsewhere. There could, however, be a way through here. The Commission have indicated

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that as an alternative to immediate closure, they would be prepared to accept a "contract" between Commission, Government and enterprise to limit the output from existing plants for a period. Under, say, option (ii) or option (iii) such a contract might allow the modernisation of Port Talbot to proceed against a clear limit on the output from the three plants as a whole. This would need to be explored urgently with the Commission; but against the background of their acknowledgement that we have already cut capacity by much more than our partners, I would not anticipate serious difficulty.

Consideration

14 While the early closure of Ravenscraig would be the most certain way of restoring BSC's financial viability, Mr MacGregor has told me that he would support a Government decision that it should be deferred. There are a number of reasons for considering deferral:

(i) early closure would require an immediate decision to instal continuous casting facilities in South Wales at a cost of some £100 million. This would be in addition to the investment of £175 million in modernising the hot strip mill at Port Talbot which I recommend should go ahead in any event.

(ii) there would be some loss of markets from early closure of Ravenscraig, although BSC claim losses would be small in relation to the total gains from closure.

(iii) It is by no means clear, if the decision to close Ravenscraig were delayed while the modernisation of the Port Talbot hot strip mill is carried out, that it would be Ravenscraig rather than Llanwern which should eventually close.

These are significant commercial and financial reasons for

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delaying closure provided the wider financial consequences are accepted by Government.

15 There are also compelling political reasons:-

(i) we have already shut far more steel capacity than any other country in the European Community. We have repeatedly said that other member states must now be seen to be doing their share of major closures. A 'contract' on the lines indicated in paragraph 13 above and in Annex 4 would give us room for manoeuvre.

(ii) we expect some upturn in steel demand next year, and to close a major plant could be made to look more like a panic reaction to a short-term crisis than a considered decision based on an examination of longer term steel demand.

(iii) immediate closure would result in serious social difficulties and could well give rise to major industrial relations problems. Figures provided by the Scottish Office show that in the Lanarkshire travel to work area, where in September total unemployment was 21.6 per cent and male unemployment 22.2 per cent, the closure of Ravenscraig, Gartcosh and the Hunterston terminal would lead to a direct increase in unemployment to 24.7 per cent overall and 26.1 per cent of males. The consequential effects of the closure on other BSC employment in Scotland, on BSC suppliers including the NCB and BR, could lead to total unemployment in the area in the range 26 to 27.5 per cent, and 29.5 to 31.5 per cent male unemployment. As already indicated, the closure in 2 or 3 years time might turn out to be at Llanwern rather than Ravenscraig. While this would be profoundly unwelcome in Wales, closure of Llanwern would probably have less serious social effects than the closure of Ravenscraig. The main area affected by the closure of Llanwern would be Newport, where total unemployment in

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October was 15.4 per cent. Complete closure would increase total unemployment to over 20 per cent.

Financial Implications

16 Whatever decisions we reach, there will be serious consequences for public sector financing. BSC are in any case likely to overshoot their EFL of £365 million for 1982/83 by about £135 million, giving a total cash requirement this year of £500 million. For 1983/84, BSC are also likely to require a minimum of £500 million to £550 million, whether or not a major plant is closed. A plant closure will not save cash in the first year since the full savings do not arise in that year. Against lower losses, there would be significant cash costs from redundancy payments and from the further capital expenditure on continuous casting required in South Wales.

17 BSC have not yet prepared cash projections for 1984/85 or 1985/86. But a marked improvement over 1983/84 is to be expected in these years in any event arising from the management action programmes described above. An early closure of a major plant would improve profitability in those years by around £100 million in each year, and there would be beneficial cash consequences of about £70 million in each year.

18 The table below illustrates this and shows the approximate effects on BSC's profit and on cash of (a) deferring a closure indefinitely and (b) deferring closure until early 1985, compared with the baseline which is option (i) - closure of a major plant in early 1983.

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£ million

	Reduction in Profit			Additional Cash Required		
	1984/85	1985/86	1986/87	1984/85	1985/86	1986/87
No closure	- 100	- 100	- 100	+ 70	+ 70	+ 100
Closure early 1985	- 100	- 20	- 0	+ 70 ←	+100 +70	0 +30

Notes: (1) Cash requirements include £30 million a year for three years for extra capital expenditure beginning in the year of a major closure.

(2) A delayed closure delays also the additional cash needed for redundancies etc.

Proposal

19 Subject to the views of colleagues, I propose to advise Ian MacGregor that he should finalise BSC's Corporate Plan for 1983-6 on the basis that a strip mill will close in 2 or 3 years time. This is in effect option (ii). We do not need to decide now which mill will close, though the probability must be that it will be Ravenscraig. If in the meantime BSC find that they are not able to make sufficient progress towards profitability either through persistent lack of demand, or through inefficient operation at a major works through lack of co-operation by the employees, then an earlier closure, partial or complete is not ruled out. I also propose to ask BSC to prepare a strategic review of Scunthorpe and Teesside, against which to assess future BSC proposals for capital investment.

20 We will need to take decisions on revising BSC's EFL for 1982/83 and 1983/84 in the light of the new BSC Plan when we receive it in a few weeks time. We will also need to take a

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decision on the Port Talbot project at the same time, in the light of the latest forecasts of steel strip demand which BSC are currently preparing, and the reaction of the Commission to the "Contract" proposals.

Public Presentation

21 I have promised to present our conclusions on the current review of BSC's strategy in a statement to Parliament. This statement will need careful presentation. It should bring out clearly 4 main themes:

(i) a continuing commitment both by BSC and the Government that the Corporation should return to profitability as quickly as practicable, given current and expected market circumstances;

(ii) our continued support for the ECSC steel regime in all its aspects, including in particular the steel price and quota regime, the control of imports from third countries, and above all the requirement that other member states must make substantial permanent cuts in steel capacity in return for state aids, to match the action we have taken in the UK;

(iii) although BSC are now preparing a plan for 1983/86 which does not include the immediate closure of one of the 5 major integrated works, this does not mean that their future is in any way guaranteed. In particular, it will be essential for continued efforts to be made, by management and workforce at each plant, to reduce costs and improve productivity and quality.

(iv) there are good commercial and financial reasons for not immediately closing any of the 5 integrated works in present circumstances, quite apart from the devastating social effect of any closure. It will be very important to stress these, and for Mr MacGregor to support them publicly, both to avoid the accusation that the Government have simply

overruled him in order to delay a politically difficult decision until after the election and to present a coherent case to the Commission. If it is accepted that there can be no major closure for the present, then there is no way of avoiding the threat of future closures hanging over not just Ravenscraig but also Llanwern, and this will certainly create political difficulties in the areas concerned.

Recommendations

22 I therefore put the following recommendations to colleagues:

1) We reaffirm that BSC's target is to return to continuing profitability as early as possible with a view to being returned to the private sector.

2) We accept option (ii). While for sound commercial reasons it would not be right to make an immediate closure now, we must recognise that one of BSC's five major works will inevitably close within two or three years.

3) We accept in principle, subject to a full case being put forward by BSC, that the Port Talbot hot strip mill modernisation project should go ahead at an estimated cost of about £175m.

4) That I ask Mr MacGregor to bring forward his 1983/86 Corporate Plan based upon the assumptions outlined in (1)-(3) above.

5) That I circulate to colleagues a draft statement that I might make to Parliament reflecting our decisions.

P J

Department of Industry

2 December 1982

Steel Market Outlook

1. An analysis of BSC's market prospects needs to take account of a number of factors. The most important is the outlook for steel consumption in the UK, but in addition it is necessary to assess likely trends in BSC market share; the proportion of the UK market supplied by the private sector producers (which take a significant amount of semi-finished steel from BSC); the proportion of the UK market taken by imports; and the prospects for steel exports by BSC. Finally, UK steel demand figures need to take account of stock changes.
2. UK steel consumption remained remarkably stable over the 5 years 1975 to 1979, varying between 15.30 and 15.80 million product tonnes of finished steel a year. There was a sharp decline in 1980 to 12.58 million tonnes, and a further fall in 1981 to 12.07 million tonnes. In 1982 steel consumption has fallen again and demand has been further depressed by a reduction in stocks.
3. BSC's latest estimates for UK steel demand are given in the table below:

UK steel demand: million product tonnes

	1981/82 (actual)	1982/83	1983/84	1984/85	1985/86
Consumption	12.5	11.9	12.0	12.25	11.75
Stock change	<u>+0.2</u>	<u>-0.5</u>	<u>+0.25</u>	<u>+0.25</u>	<u>-0.25</u>
Demand	12.7	11.4	12.25	12.5	11.5

BSC consider it likely that there will be a cyclical decline in UK steel demand in 1985. 1

Note: BSC figures are for years ending 31 March. The 1981/82 consumption figure is higher than the consumption for 1981 as a whole since there was an increase in UK steel consumption in January to March 1982. There has since been a sharp decline.

4. The expectation that UK steel demand in 1985 will be no greater than in 1980 is in line with European Commission forecasts for steel demand in the Community as a whole, which is expected to recover to the 1980 level by 1985. There is a difference between the basis for the two forecasts, however: the 1980 steel consumption figure in the European Community was only slightly below the average consumption in the preceding 4 years, whereas in the UK steel demand dropped sharply in 1980. There is perhaps therefore some prospect of rather greater increase in UK steel demand in the period to 1985 than the Community average, if the performance and competitiveness of UK manufacturing industry improves relative to other European countries over the next 3 years.

5. Further significant growth of UK market share by imports is not expected; a combination of Community-wide market discipline and BSC determination not to lose further market share make it reasonable to assume that the Corporation will at least hold the line at the present level of 48 per cent market share and have a reasonable chance of achieving their target of a return to a 50 per cent market share.

6. The outlook for exports is much more gloomy. In the December 1981 Plan for 1982/85, BSC forecast that exports would increase to 3.6 million product tonnes a year, well above historical levels, as the table below shows. We believed at the time that BSC's export assumptions were optimistic; BSC now expect to export only 2.3 million tonnes in 1982/83, and have revised their forecast export level downwards to 2.5 million tonnes a year in 1984/85. The main reason for this revision is the action of the US authorities in restricting steel imports. The direct effect on BSC's own exports to the USA will not be serious, but overall the measures will have the effect of diverting onto world markets a significant volume of steel which would otherwise have gone to the USA. Given the current degree of excess world steel capacity and low demand, this means that the steel export outlook is much less promising than a year ago.

BSC Steel Exports: Million product tonnes

	1977/8	1978/9	1979/80	1980/1	1981/2	1982/3	1983/4	1984/5
Actual	3.2	2.9	2.5	2.3	2.7			
Dec.81 Plan						3.6	3.6	3.6
Latest Outlook						2.3	2.3	2.5

7. The drop in export deliveries in 1982/83 is the largest single factor in the current decline in BSC's steel production, and the revised outlook for exports over the next few years is one of the main reasons why BSC have found it necessary to examine the future of their 5 major integrated steelworks.
8. BSC have combined all the factors affecting the demand for their steel to calculate a range of likely level of BSC steel sales during the next 3 years. The results are set out in the Table below:

Minimum and Maximum BSC sales 1983/86: million product tonnes a year

	Minimum	Maximum
UK steel demand	11.5	13.5
BSC market share	46%	51%
BSC sales to customers and stockholders	5.3	6.9
BSC to private sector	1.2	1.6
BSC exports	2.0	3.5
Total BSC sales	8.5	12.0
Liquid steel equivalent (m.tonnes)	11.3	16.0

The most likely range of BSC deliveries is 9.5 to 10.5 million product tonnes a year, which means a most likely liquid steel equivalent production of between 12.6 and 14.0 million tonnes. For comparison, BSC produced 14 million tonnes of liquid steel in 1981/82, but over the 4 months July to October 1982 were producing steel at an annual rate of only 9.7 million tonnes, hence the high level of current operating losses.

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BSC: Major closure options

1. BSC currently have the physical capacity to produce 21.3 million tonnes a year of liquid steel. Manned capacity is 15.3 million tonnes. As explained in the main paper BSC do not expect to have to produce more than 14 million tonnes of liquid steel over the next 3 years on their central assumption, with 16 million tonnes per year as the maximum of the range of plausible estimates.

2 The physical capacity of each of BSC's 5 major integrated works is set out below:

	million tonnes of liquid steel a year
Ravenscraig	2.8 -
Port Talbot	2.9
Llanwern	2.8 -
Teesside	3.5
Scunthorpe	3.8

The closure of one of the strip mills would therefore reduce physical capacity to 18.5 million tonnes a year, which would give BSC a very comfortable margin of spare capacity over and above the 16 million tonnes which is the maximum foreseeable demand over the next 3 years. The likelihood that BSC will ever need 18.5 million tonnes of capacity is remote. Hence BSC have examined the option of closing one of their 5 integrated steelworks.

This possibility was first looked at in some detail in the context of the strip mills review, when attention was concentrated on Ravenscraig, Llanwern and Port Talbot. It has since been widened to include Teesside and Scunthorpe, but the analysis of the future loading and development of these works has not been carried out in the same depth as for the Strip Mills.

3. BSC's assessment of the major closure options is attached ~~as~~ an Appendix. It concludes firmly that Ravenscraig should close. The annual savings expected from the closure of each of the 3 integrated works considered to be candidates for closure is as follows:

	Annual saving £ Million
Ravenscraig	<u>111</u>
Llanwern	83
Teesside	58

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However the difference between the savings at Ravenscraig and Llanwern are narrowed if the closure of the ingot route at Ravenscraig is treated separately: this is an independent action saving £15 million a year, hence the closure of the remainder of Ravenscraig would save £96 million in a full year.

4. The choice of Ravenscraig as closure candidate depends heavily on a major capital investment programme going ahead in South Wales:

the modernisation of the Port Talbot Hot Strip Mill and the installation of further continuous casting, at a combined cost of about £280 million. This programme would be the inevitable consequence of the early closure of Ravenscraig. By contrast, BSC have separately provided the Department with capital expenditure estimates consequent on the closure of Llanwern. The Port Talbot modernisation project would still need to go ahead, but the further capital investment required if Llanwern were closed totals only £41 million as against the £123 million required if Ravenscraig is closed. If a closure is delayed, the preference for Llanwern will erode and the balance of advantage might swing towards Ravenscraig, especially if cost and quality improved there.

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BSC ASSESSMENT OF MAJOR CLOSURE OPTIONS

The criteria for choosing the preferred closure candidate are discussed below:-

- (i) Effect on ability to meet finished steel product demand
 - (ii) Current Cost performance
 - (iii) Impact of choice on future capital programmes.
- (i) Ability to meet finished steel product demand

Effective demand is for finished steel products and the selection of which liquid steel capacity to close must be affected by the feasibility of feeding from the retained liquid steel producing sites, the finishing capacity with which to satisfy demand in terms of both volume and specification for finished steel.

In judging finished steel demand requirements regard should be paid to the growing customer preference for product based on continuously cast feedstock rather than for material rolled from ingot route steel.

These highly complex criteria are reported in detail in the available appendices. The key issues are:-

Likely Impact on ability to meet product demand

<u>Closure of</u>	<u>Steelmaking</u>	<u>Finishing</u>
Llanwern	None	Strong customer preference for * both quality and coil weight.
Port Talbot	Loss of 16kt/w concast capability	None (prior to the completion of proposed HSM refurbishment).
Ravenscraig	Loss of 36kt/w concast capability	Small difficulty related to minority of customers with preference for this mill.
Scunthorpe	Loss of 38kt/w concast capability (inc. unique concast billet BOS capability)	Severe impact on commercial billet capability. Impacts also joists and thin plate capacity and Z piling capability.
Teesside	Loss of 55kt/w concast capability including main source of concast blooms (Feedstock for Workington Rail)	Sole source of heavy beams, columns and Larssen piling. Until Port Talbot Hot Strip Mill scheme approved and completed Teesside is only facility capable of handling rolling of Stainless coil and 'triple width' strip for welded tubes feedstock.

* Unless Llanwern is converted to concast this preference will erode as the now strongly emerging consumer preference for concast sourced material gathers force.

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The key conclusions are:-

- (1) The finishing facilities of all sites other than Port Talbot and Ravenscraig are extremely important to sustain the necessary capability in product finishing areas.
- (2) All sites except Llanwern have concast capability which is of increasing importance to meeting customer preference in the market place. The concast routes are also less costly to operate than the alternative ingot route processes.

Therefore on the criteria of the ability to meet customer requirements there is no clear candidate for total site closure. Looking at finishing facilities only, Ravenscraig or Port Talbot could be closed, but to extend the closure to the whole site would require replacement elsewhere of the lost concast capability. (See (iii) for capital spend implications.)

(ii) Current Cost Performances

In choosing between various contenders any closure should ideally eliminate the highest cost production for comparable products.

<u>£ per tonne</u>	<u>Hot Rolled Coil</u>		<u>Cold Reduced Coil</u>	
	<u>Standard Cost</u>	<u>Actual Cost</u>	<u>Standard Cost</u>	<u>Actual Cost</u>
Ravenscraig	150	170	207	239
Port Talbot	145	153	200	214
Llanwern	155	160	196	209

The high standard costs at Ravenscraig reflect the inherent high costs of the facility arising from its location (separate from its port), inefficient coke ovens and low capacity steel-making vessels. Additional penalties at Ravenscraig are transport to final finishing locations at Gartcosh and Shotton and remoteness from main domestic markets in the West Midlands.

Therefore On the criteria of current and foreseeable costs for the major strip products the closure candidate should be Ravenscraig.

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Owing to the considerable overlap in facilities among the 'BOS Works', both in steelmaking and in the finishing mills, it is possible to eliminate any one of them and to cover most of the product demand, albeit in some cases with considerable transfer of semis between remaining sites. It is therefore pertinent to compare the relative costs of liquid steel at the five works.

	<u>Liquid Steel Costs April/September 1982</u>		
	<u>Standard</u>	<u>Actual</u>	<u>Better/(worse)</u>
	<u>£ per tonne</u>	<u>£ per tonne</u>	<u>than Standard</u>
Llanwern	102	104	(2)
Port Talbot	91	88	3
Ravenscraig	103	120	(17)
Teesside	104	113	(9)
Scunthorpe	99	107	(8)

On this analysis Teesside is an alternative choice for closure to Ravenscraig. If this were done it would be necessary:-

- (a) to replace elsewhere the lost concast facilities (bloom and slab)
- (b) to retain Lackenby No. 10 mill to provide heavy beams and columns
- (c) to find substitute sources for Stainless Hot Band and Tube Strip

(iii) Impact of closure choice on future capital programmes

For the purposes of this analysis we have considered that the superior cost performance of Port Talbot and Scunthorpe and the important market preference for Llanwern have eliminated them from the possible closure list.

The calculations also ignore the proposed £180 million programme for renovation of the Port Talbot Hot Strip Mill which is common to both of the practical alternatives.

We have also ignored minor capital schemes which are not significantly different between the two sites.

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Capital Expenditure avoided or caused by individual works closures

<u>£m</u>	<u>Schemes avoided</u>	<u>Schemes caused</u>	<u>Net Impact</u> <u>(over 3/4</u> <u>years)</u>
<u>If Ravenscraig closed</u>			
	Coke oven replacement	Coke ovens and concast for S. Wales	41 102
		Coal injection (Teesside)	10
	30		153
			<u>+ 123</u>

If Teesside closed

	Redcar coke ovens (balance uncommitted)	Coke ovens (Ravenscraig)	41	35	
	Sub Lances	Concast (Ravenscraig)	6	12	
		Reheat facilities (Teesside No. 1 Mill)		13	
		Piling resite (Scunthorpe)		3	
		Concast		102	
	47			165	<u>+ 118</u>

This analysis shows that the issue of consequential capital expenditure does not differentiate between the two options.

Differentiation between the five large sites according to the different criteria are:

	<u>Preferred Closure Candidate</u>
Finished Steel Product Demand	Ravenscraig or Port Talbot
Cost Performance	Ravenscraig or Teesside
Future Capital Expenditure Implications	No significant difference between Ravenscraig or Teesside

Conclusion

The candidate for closure taking into account product constraints, cost performance and prospective capital costs, should be Ravenscraig.

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Recommendation

A plan to consolidate Strip Group operations into Wales will provide the basis for substantial short term loss reductions. If this advantage is to be sustained through to the 1990s, and the group is to be required to develop into a profitable and potentially free standing enterprise the two major capital commitments for the Port Talbot Hot Strip Mill and for extra concast capability in South Wales (£180 million and £100 million respectively) are essential. They will be built into our capital expenditure plan.

The recommended complete closure of the Ravenscraig complex (including Gartcosh and Hunterston) has within it alternative lesser options:-

	<u>Annual Profit Improvement</u> (Strip Group Only)	<u>Manning Reduction</u>	<u>Asset Write off</u>
1. No action	- Zero	Zero	Zero
2. Close only the ingot route*	£15m	700	} N/A
3. Close ingot route and Gartcosh	£28m	1350	
4. Close ingot route, Gartcosh and one Blast Furnace	£44m	1930	
5. Close ingot route, Gartcosh, one Blast Furnace and Hot Strip Mill	£55m	2980	
6. Total closure	£101m	4810	£200m

* This action is already included in the Management action plan.

- NB
- (1) These savings are before any penalties arising from inadequate availability of concast material. This is not expected to be significant in the first two years following the closure of Ravenscraig.
 - (2) The reality of these alternatives should not be taken as an indication that the officers of the Corporation are less than clear in their recommendation. The recommendation is complete closure.

BSC

10 November 1982

The Port Talbot Modernisation Project

BSC put forward in July a proposal for the modernisation of the 30 year old Hot Strip Mill (HSM) at Port Talbot. The proposed modernisation scheme will cost about £175 million at outturn prices, and includes the following main objectives:

- (i) reduction in energy consumption
- (ii) ability to provide heavier coils required by many customers
- (iii) ability to produce hot rolled coil at smaller gauges
- (iv) better quality and finish on coils.

The direct cost savings resulting from this project, if the Hot Strip Mill were operated at the current Plan loading for the Port Talbot HSM, is £13.5 million a year before depreciation. But it is estimated that if the project were not to go ahead then Port Talbot works, on which £350 million has been spent for modernisation in recent years, including the installation of continuous casting which came into operation in August 1982, would gradually lose its present market. BSC calculate that the benefits from the HSM project increase to £22.5 million a year net of depreciation if account is taken of the savings resulting from avoiding the expected loss of business if the project does

not go ahead. Alternatively, the cost savings which would arise if the modernised Hot Strip mill were run at nearer its full rated capacity of 2.6 million tonnes a year, instead of at the current Plan loading of 1.6 million tonnes a year, would be £23.3 million a year after depreciation without taking account of volume loss avoidance benefits.

It can be seen that the justification for the Port Talbot HSM project rests heavily on fully loading the Port Talbot works, which in turn requires the closure of one of BSC's other strip mills. If the Port Talbot HSM project does not go ahead, and if no other BSC strip works is closed, then any orders which Port Talbot might lose could be supplied from another works, at considerable profit to that other works from the increased loading.

But Port Talbot is already, before the starting up of continuous casting, the lowest cost producer of hot rolled coil in BSC. This is largely due to its low costs of producing liquid steel. With continuous casting and a modernised HSM, the Port Talbot works would increase its advantage over Llanwern and Ravenscraig, and it would be internationally competitive into the 1990's. BSC are confident that Port Talbot, at least, has a long term future as an efficient and profitable steelworks if this project goes ahead.

Failure to invest in BSC's strip mills would mean that they would gradually become more and more uncompetitive and, eventually,

all would have to close. Investment in all 3 strip mills, given the present demand outlook, would be absurd. BSC regard investment in the Port Talbot HSM modernisation project as the highest priority - the project will take about 3½ years to complete - and there are no grounds on which to question BSC's judgement.

In considering the choice of strip mill for closure, it is necessary to look at the capacity and demand implications, as well as the relative costs and quality at each strip mill.

The potential capacity of each of the 3 strip mills is shown below:

Port Talbot	2.60 (after modernisation)
Llanwern	2.75
Ravenscraig	1.70
	<hr/>
	7.05 million tonnes

Note; the capacity of the present HSM at Port Talbot is 2.25m tonnes.

BSC have provided very preliminary forecasts of hot rolled coil demand to 1986/87 which show that the maximum expected production of hot rolled coil (HRC) by BSC, including exports, will not exceed 4.3 million tonnes over this period. This means that the closure of Llanwern rather than Ravenscraig could leave BSC with no spare capacity, unless there is a significant further fall in demand for HRC.

Capacity considerations point to the choice of Ravenscraig being closed if a decision is taken now, but if a decision is deferred for 2 or 3 years than the demand outlook at the time, coupled with consideration of the relative costs at Llanwern and Ravenscraig, will be the key factors in reaching a decision on which works should close.

European Community aspects

1 BSC's return to profitability would be greatly helped by the success of the ECSC steel regime in all its aspects: price stabilisation, the phasing out of state subsidies, substantial capacity reduction, and restraint agreements to prevent an upsurge in steel imports from third countries. We are strongly supporting the Commission in their efforts to secure full adherence to the agreed policies.

2 BSC have already notified to the Commission very substantial reductions in capacity since 1980, and the further closures now being announced by the Corporation, to be followed by the closure of the Ravenscraig ingot route, will provide significant new reductions in capacity against which we can expect the Commission to authorise a substantial further tranche of finance for BSC, in addition to the £400 million for 1982/83 agreed by the Commission on 25 November. The closure of a strip mill, even if the closure were deferred for 2 or 3 years, would resolve all problems with the Commission.

3 Without a strip mill closure, there will be difficulty in getting Commission approval for the Port Talbot modernisation project. As explained in Annex 3, the Port Talbot HSM project will increase hot rolled coil capacity at Port Talbot by 0.35 million tonnes. The Commission will, we know, suggest the eventual closure of another strip mill as a condition of approving the Port Talbot project. But at my meeting with him on

11 November, M Davignon suggested that one way of dealing with problems of excess capacity would be for the Commission, the steel enterprise and the appropriate Government to enter into a legally binding "contract" to limit the output of particular plants, as an alternative to complete closure.

4 The current loading at Port Talbot is only 1.6 million tonnes a year, and BSC have spare capacity for hot rolled coil production of over 2 million tonnes. It is proposed to explore with the Commission the possibility of entering into a contract, along the lines suggested by M Davignon, under which BSC would be required to limit their production by, say, up to 1 million tonnes a year of hot rolled coil below the potential capacity for this product, in return for BSC being authorised to go ahead with the Port Talbot HSM project. A contract limiting capacity would need to be as flexible as possible, and not rigidly restrict production at a particular works. And when a strip mill eventually closed, the contract would no longer apply since its purposes would be entirely met by the closure.

5 The purpose of seeking to negotiate a contract on the above lines is to give the Government and BSC the greatest possible room for manoeuvre, and would leave the decision and timing of a strip mill closure entirely in UK Government hands. The proposal would not be put forward as a policy alternative to the clear need to close a BSC strip mill.