

Prime Minister

The export price is not calculated - it is market-determined.

The present surplus of UK coal is P.0730 not determined by

PRIME MINISTER that but more by the pace of our

pit closures programme - itself determined largely by political pressure.

M/S 4/5

Invergordon Smelter

E(82)38 and 39

How is the export price of coal calculated. There

must be some means of ensuring that it is not

below cost? That

would mean phasing out lower the old pits - and that would be a good thing.

BACKGROUND

The consequences of the closure of the aluminium smelter at Invergordon have been discussed several times by the Committee, the most recent being E(82)7th Meeting on 7 March and E(82)10th Meeting on 23 March. At the second of those meetings the Committee clearly tended to the view that it would be difficult to construct defensible arrangements for subsidising the smelter on the scale required for a new operator to be willing to re-open it. The Secretary of State for Scotland was accordingly invited -

(i) to summarise the arguments which could be used publicly against basing a power contract for the smelter on hydro-electric power supplies; and

(ii) to put forward proposals for an increase in the grants available to the Highlands and Islands Development Board (HIDB) to stimulate investment and employment in the Invergordon area.

E(82)38, with which the Secretary of State for Energy is associated, has been prepared in response to the first remit; E(82)39 is the response to the second.

2. However, E(82)39 does not favour an increase in the provision for the HIDB for general purposes. Instead, it proposes that the option based on supply by the National Coal Board (NCB) of coal at export prices for the generation of electricity should be revived; an option on these lines was described in E(82)19 and 31 and discussed at E(82)7th Meeting. As now put forward, it is modified by the suggestion that

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the additional subsidy that would be required should be provided by way of direct grants for a period of five years from the HIDB to the smelter operator. The Secretary of State for Scotland recommends that officials should have urgent discussions with the NCB and the Scottish Electricity Boards (SEB) to draw up a detailed proposal to be cleared with the Commission and offered to potential operators.

3. It will be convenient for the Committee to consider E(82)39 first: if the proposals there are accepted, there will be no need to spend much time in considering the public justification for discarding alternatives; if not, it may be necessary for the Committee to discuss how rejection of the current proposals will be publicly defended. The agenda is arranged accordingly.

MAIN ISSUES

4. The arguments in favour of offering a subsidy to potential smelter operators are based on the serious effects of permanent closure on economic activity and employment in the Scottish Highlands, and the political consequences of this. At previous meetings of the Committee it has been estimated that the total loss of jobs is likely to be at least 1,500. This would raise unemployment in the area to 25 per cent, with little or no prospect of alternative employment. The Government has already come under heavy criticism.

5. The main arguments against subsidy are as follows.

(a) General Economic:

The world aluminium industry is depressed; and even in the longer term, the United Kingdom will suffer from a permanent competitive disadvantage against countries with access to large supplies of cheap energy.

(b) Repercussions:

If subsidies are given at Invergordon it will be difficult to resist pressure for similar subsidies to the aluminium smelters at Anglesey and at Lynemouth in North East England,



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both of which (for different reasons) will fairly soon face substantial increases in their electricity costs. More generally, other large users of electricity could claim similar treatment.

(c) Cost:

The cost of subsidy can be assessed in a variety of ways. The minimum estimate (in E(82)39) is £20 million a year - about half through the supply of coal at export prices and half through grants by the HIDB. This would almost certainly be considerably increased by eventual subsidies at Lynemouth (where electricity is also produced from cheap supplies of coal) and possibly Anglesey.

A further point, particularly relevant to the current proposal is -

(d) Position of the Coal Industry:

Several members of the Committee have been opposed to long-term subsidy arrangements linked to coal supplies, on the grounds that this encourages the NCB to maintain its activities at an uneconomic level.

There has also been concern about the potential Community implications and possible difficulties with the Commission.

6. It is not clear that the Secretary of State for Scotland's current proposals succeed in avoiding the difficulties. Most of the arguments set out in paragraph 10 of E(82)39 have already been considered by the Committee. You may think that the following arguments particularly need to be probed.

Limitation of Offer to Five Years (paragraph 10(e))

7. You will wish to ask whether it is realistic to suppose that subsidy could be withdrawn, or even substantially reduced, after five years if, as seems likely, that entailed that continued operation of the smelter would not be economically viable.

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8. A possibility which you may wish to explore, and which may be suggested by other members of the Committee, would be to offer a tapering subsidy from the HADB. This would avoid the difficulties of overnight withdrawal of subsidy, and could be defended by reference to the likelihood that world aluminium prices will rise. And, even if it is not acceptable to the potential operators, at least it would allow the Government to say that a reasonable offer had been made.

9. On the other hand, once the Government opens negotiations with a potential operator it will come under heavy pressure to make concessions; and there is a risk that it could be accused of making proposals which so obviously stood no chance of being acceptable as to be a transparent attempt to shift the political blame elsewhere.

Community Implications (paragraph 10(g))

10. Paragraph 8 of E(82)39 is not quite correct as it stands. First, an additional grant to the HADB would not in itself constitute a State aid which is notifiable to the Commission: it would be the payment of the subsidy to the smelter operator which would be notifiable. Secondly, and more important, it is not the pricing of coal at export prices which is questionable, but the funding of the NCB's consequential deficit, which is notifiable under Decision 528/76 of the European Coal and Steel Community.

11. E(82)38 suggests that there could well have been difficulties with the Commission over the discarded hydro options. It is also relevant that in E(82)31, the Secretary of State for Scotland said the following about a previous version of the coal option, also based on a supply of coal at export prices, but with direct grant paid by the Government to the smelter operator.

" Recognising that coal [at export prices] will not produce sufficiently cheap electricity [the Secretary of State for Energy] has proposed that the Scottish Office should in addition pay a direct grant to the smelter operator. It



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would certainly be open to me to pay grant under existing legislation towards the setting-up of a new smelter operation and towards any new investment which the new operator proposed to put into the plant. But any assistance I could offer would be modest in relation to the smelter's annual electricity bill. I believe that to take powers as the Secretary of State for Energy suggests to pay such a new operating subsidy would provoke a major row with the Commission. It would be a blatant breach of the EEC Treaty and would clearly be more open to challenge than would any subsidy provided through the NCB or South of Scotland Electricity Board".

12. Presumably the Secretary of State for Scotland must believe that subsidy through the HIDB would avoid, or at least reduce, these drawbacks. But this may not be so: the Commission is likely to regard it for these purposes as an extension of Government.*

Repercussive Effects on Industry in general (paragraph 10(h))

13. It is not obvious that the current proposal has advantages compared with previous suggestions. It is true that providing subsidy through the HIDB rather than direct from Government may have presentational advantages; but a subsidy for the smelter at Anglesey could presumably be channelled equally well through the Welsh Development Agency. And in some respects it would be easier to resist repercussions from a scheme based on hydro-power, which exists on a significant scale only in the Scottish Highlands.

Public Presentation

14. Public presentation will naturally depend on the decisions of substance. It may be helpful to concentrate more heavily on the general arguments than in E(82)38, since public opinion may not be much impressed by the niceties of operation of the Scottish electricity generating system.

* Since neither the Lord Advocate nor a Minister from the FCO is available to attend the meeting, the FCO will be circulating a letter on the Community aspects.



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15. In the light of the Committee's decisions, you may wish to ask the Secretary of State for Scotland, in consultation with the Secretary of State for Energy and the Chief Secretary, Treasury, to prepare either a statement or background briefing which could be made available to the press and the Government's supporters.

HANDLING

16. After the Secretary of State for Scotland has made his opening remarks, you may wish to ask the Secretary of State for Energy for his views. The Chief Secretary, Treasury can be expected to comment from the standpoint of public expenditure and nationalised industry policy. The Secretary of State for Industry may have views on potential repercussions.

CONCLUSIONS

17. You will wish to reach conclusions on the following:

- i. Do the proposals by the Secretary of State for Scotland in E(82)39 form at least a satisfactory basis for further study on the lines which he proposes?
- ii. If not,
 - a. would there be any tactical advantage in making a more limited offer to potential operators, even though this were virtually certain to be refused; or
 - b. should the Committee conclude that it is impossible to devise satisfactory subsidy arrangements for Invergordon and that there is no point in pursuing the matter further?
- iii. How should the Government's decisions be publicly presented?

PLG
P L GREGSON

28 April 1982

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