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PM.

SUBJECT.

10 DOWNING STREET

From the Private Secretary

27 May 1982

bc. h. walkers

gc. market sec.

Dear Mr. ...

INVERGORDON SMELTER

The Prime Minister held a short meeting yesterday evening on the matter raised in your Secretary of State's minute of 17 May together with subsequent correspondence. The Secretaries of State for Industry, Energy and Employment, and the Chief Secretary, Treasury, and Mr. Sparrow were also present.

Your Secretary of State said that he fully understood his colleagues' anxiety to establish a clear ring fence around the subsidy for the Invergordon smelter. But he saw very great difficulties about the proposal to channel the whole of the subsidy through the Highlands and Islands Development Board (HIDB). The fact was that we had told the British Aluminium Company (BACO) that we could not subsidise the smelter to the tune of £16 million a year, yet we would now be seen to be offering a subsidy for £20 million a year to someone else. Secondly, the "headline" figure of £20 million would cause difficulty with the EEC, and would generally make the Government subsidy visible and open to attack. Finally, if there was to be no subsidised power contract, the effect would simply be to enable the NCB to sell coal at higher prices than it would otherwise be able to obtain in the open market, and thus to improve pointlessly their financial position.

In discussion, it was argued that a direct subsidy to the power contract for Invergordon would present Industry and Energy Ministers with insuperable problems with other high energy using industries. A number of such industries were watching events very carefully, and were poised, if such a subsidy were introduced, to argue that the arrangements should be extended to themselves. There were no arguments available for denying a subsidy in these cases once one had been granted to Invergordon. There might well also be - although the legal position seemed not to be clear - a serious problem in relation to claims of undue preference. It was true that Invergordon would be the largest consumer of electricity in Scotland, and on this basis there might be a case for the new operator securing a low coal price after negotiation with the NCB. On the other hand, the power supply for Invergordon was electricity and not coal, and it was arguable that the Electricity Boards had already secured, in virtue of their large purchase from the NCB, the discount which was appropriate. Furthermore, the subsidy which had been in question so far as BACO was

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concerned had been £16 million a year until the end of the century. All that was now offered to the new operator would be £20 million a year for 5 years. There would be no question of concealing the size of the total subsidy if the Scottish Secretary's preferred route were chosen: the EEC Commission, and probably the PAC, would scrutinise the arrangements carefully, and there was likely to be publicity both from these scrutinies and also from potential operators of the smelter. Finally, there would be no windfall benefit to the NCB, since insofar as they sold coal at the power station price rather than at a lower price, their deficit would be smaller and so the Government's deficit grant would be correspondingly smaller. There would be, thus, no benefit to public funds from the subsidised power contract route.

BF. || Summing up the discussion, the Prime Minister said that, notwithstanding the problems of presentation which your Secretary of State had revealed, it was vital to ring fence the proposed subsidy as robustly as possible. Given that there was no advantage so far as the public finances were concerned in one method of subsidy rather than another, she preferred the arrangement which offered the best prospect of resisting further claims for subsidy. Your Secretary of State should, therefore, explore with the potential operating companies the possibility of re-opening the smelter on the basis of a £20 million per annum grant through HADB and without any direct coal or electricity subsidy.

I am sending copies of this letter to the Private Secretaries to other members of E Committee, Adam Peat (Welsh Office), John Sparrow and David Wright (Cabinet Office).

Yours sincerely,

Michael Scholar

Muir Russell, Esq.,
Scottish Office.

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