



FROM: CHIEF SECRETARY

DATE: 3 October 1985

CPH
cc P. MONYSON

PRIME MINISTER

PROPOSED LINWOOD PULP AND PAPER PLANT

George Younger wrote to you on 1 October about regional assistance to Oy Kaukas.

2 I was not able to agree to the proposal because it broke the guidelines for administering our regional assistance policy, and George could give me no clear assurance about the public expenditure consequences.

3 The guidelines seek to ensure that the objective of the new policy, relating to jobs rather than investment, is achieved. They lay down a cost/job ceiling of £17,000. In this case the cost/job would be £25,000. George refers to indirect jobs in forestry and clay. The cost/job ceiling relates to direct jobs - there will in all cases be further indirect job effects. This is in fact a highly capital intensive project, involving the importation of around £100 million of equipment.

4 The guidelines also test the viability and economic efficiency of proposals. This case has to rely on a presumption of a project life of 20 years, twice that normally used. Also much of the production would be sold in the United States, and therefore both viability and economic efficiency will be vulnerable to exchange rate movements.

5 I am also concerned at the public expenditure position. Regional assistance is not cash limited, and the guidelines act not only to secure value for money in terms of cost/job, but also as a restraint on the expenditure. George was unable to give me a clear assurance that the cost of this project would be contained within his PES provision.

6 My concerns are increased because this case follows a decision in June to offer £15 million of regional assistance to Digital Equipment Corporation to set up a plant at Bathgate. In that case also the cost/job was very much higher than the guideline. My predecessor was persuaded to agree to this assistance on the basis of undertakings by Norman Tebbit and George Younger that further breaches to the guidelines would be unlikely.

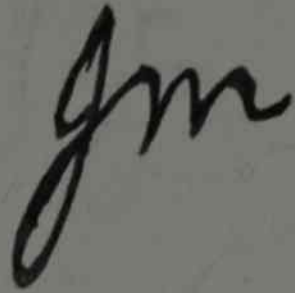
7 It was with considerable reluctance that I made a compromise proposal to George for assistance of £10 million, in recognition of his strong interest in the Oy Kaukas project, and I felt that as the amount of assistance had been negotiated downward, further effort should be made to reduce it to a level at which the cost/job guideline would be within an acceptable margin of the guideline.

8 I do not believe that we should accept a situation in which the guidelines are repeatedly ignored. This will not achieve our jobs-related policy objective, and there are very clear dangers for control of public expenditure. Whatever your decision in the case, I should be grateful if you would ask colleagues to ensure that in future the guidelines - particularly that relating to cost/job - are adhered to. If the very rare case arises where other imperatives require assistance to be given although the guidelines would be breached, the amount of assistance should be deducted from the departments' provision for cash limited expenditure.

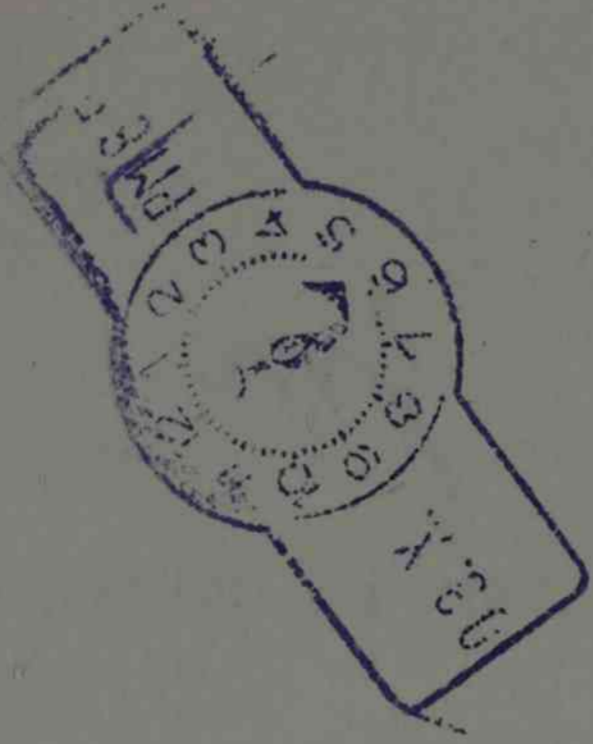
I question the need for this. If you decide that Mr Younger will have to find the £4m (or even £2m) for his cash limits, it will speak for itself in future cases. If you do not, it does not help much to circulate a general exhortation.

DR

9 I am copying to George Younger, Leon Brittan, and
Sir Robert Armstrong.

A handwritten signature in cursive script, consisting of the letters 'g' and 'm' joined together.

JOHN MacGREGOR



R.



NEW ST. ANDREWS HOUSE
EDINBURGH EH1 3SX

cc P. Morrison

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Prime Minister

1 October 1985

PROPOSED LINWOOD PULP AND PAPER PLANT

1 In view of its political importance in Scotland, I must reluctantly involve you in a decision about the regional assistance to be offered to a Finnish company, OY KAUKAS AB. The company is considering establishing a major pulp and paper plant at Linwood to manufacture lightweight coated (lwc) paper. If the project goes ahead it will be one of the most substantial and promising investments in manufacturing industry in Scotland since 1979.

2 Total investment costs are around £190m and the project, if it went ahead, would create nearly 500 jobs at Linwood and up to 400 indirect jobs elsewhere in peripheral areas including the Highlands and South West Scotland from where the wood would come and the Cornish clay pits (since clay is used in the manufacturing process).

3 OY KAUKAS AB is a diversified wood processing company employing 2,800 people in Finland. It is a partner in a company manufacturing lwc paper in West Germany, which offers an alternative location for the project.

4 There is no doubt about the attractiveness of the project in industrial terms. All UK consumption of lwc paper (about 115,000 tons a year) is at present based on

imported supplies. As well as catering for the domestic market the mill would be a major exporter and the world market is estimated to grow substantially. The viability and economic efficiency of the company's plans have been very thoroughly tested. The plant would be based on our own supplies of timber which are expected to increase rapidly as forestry plantings mature over the coming decade. Without it they would face an uncertain market probably increasing the dependence they presently have on exports of wood to Scandinavia. The benefits in terms of employment and to the forestry industry are therefore obvious.

5 The decision which remains to be taken is how much regional assistance we should offer. In terms of the normal rules established last year as part of the changes in regional policy we announced then, the maximum permitted would be around £8m; this is because the cost per job calculations permit only the inclusion of the 500 jobs internal to the factory, although in this case the 400 secured outside in forestry are also a major benefit. Locate in Scotland, who have handled the detailed negotiations with the company, are clear that this will not be sufficient to win the project. They believe that a £12m package of assistance is needed (representing 7% of the project costs). The Scottish Industrial Advisory Board, who advise me on selective financial assistance offers, strongly endorsed this package when they considered the case at their August meeting. This proposed assistance though substantial is modest as a proportion of the total investment which it would secure; it compares with £35m which would have been available automatically in Regional Development Grant before the changes we made last year and an actual grant expenditure including RDG and selective assistance of £28 m on the pulp mill which went to Shotton in 1980.

£ 170m
total.

6 When the new regional aid arrangements were introduced it was agreed that offers of assistance in excess of the normal rules had to be cleared with Treasury, and John MacGregor and I have together been considering the case over the last few

weeks. He has helpfully recognised the exceptional nature of the situation and I gratefully acknowledge that he has felt able to agree to an offer package of £10m. Unfortunately, having sounded out the firm's accountants, Locate in Scotland are clear that this would not be sufficient to persuade the company to invest here. A 20% grant is available in Germany and £12m is the minimum likely to secure the project for the UK. I have given what assurances I can about the PES implications but have been unable to obtain Treasury agreement to this offer.

7 My purpose in minuting to you is to underline the political significance of the case in Scotland. On your recent visit, you will have appreciated the concern, for example, about the future of Ravenscraig and the closure of Gartcosh. Since then substantial lay-offs have been announced at Scott Lithgow. Against that background, a new major investment at Linwood, where the Talbot car factory closed some years ago, would be widely appreciated. Indeed if failure to attract such a substantial investment could be attributed to the difference between a £10m and £12m aid package our supporters in the West of Scotland would find this impossible to understand. I should add that the Finns have issued a press statement about their scheme and a good deal of the detail is known locally.

8 The timetable in terms of the company's planning is now very tight and a decision must be reached quickly. I hope you will agree that the offer of the £12m package can now be made. If a meeting would be helpful I am, of course, at your disposal.

9 I am copying this minute to Leon Brittan, Nigel Lawson and John MacGregor. A copy also goes to Sir Robert Armstrong.

G.Y.

G.Y.



Prime Minister

To Mr

Agree that Mr Younger may offer £12 m provided he is willing to find £4 m of it from within his cash limited expenditure?

MR NORRGROVE

(You could if you wished 3 October 1985

JRW

ask him to find £2 m, leaving the Treasury to find the other £2 m as they have already offered - 3/10.

LINWOOD PULP AND PAPER PLANT

but £4m would be salutary and Mr Younger can afford it.)

Mr
✓
The whole £4m

George Younger wants to break the regional policy guidelines by topping up the £8m regional development grant permissible on this project by a further £4m of selective assistance. The Treasury rightly want to draw the line to avoid further breaches of our new policy, and further subsidies from non-cash limited funds.

The industrial advantages of the project are limited. It will be highly vulnerable to shifts in exchange rates and in the market for pulp, and will not break even until around 1990. The project does not create a particularly large number of indirect jobs in its supplier industries.

Nevertheless, if the political imperatives are overwhelming then we would recommend that George Younger be permitted to top up the RDG provided that all of the extra assistance (about £4m) is found from within the existing Scottish block. This would limit the damage to our regional policy guidelines and discourage others from seeking to take advantage of the breach.

ie including £4m already offered by the Treasury

Peter Warry

PETER WARRY

PRIME MINISTER

SECTION 7 ASSISTANCE

You agreed earlier that the Secretary of State for Scotland could offer £12 million of assistance to Oy kaukas to set up a pulp mill in Scotland, £4 million above the maximum provided for under the cost per job guidelines. You made your agreement conditional upon his being prepared to find the £4 million from within his provision for cash limited Scottish expenditure.

The Scottish Office say (letter at Flag A) that he is willing to transfer £4 million from his cash limited provision assuming that the money cannot be found within the baseline provision for selective financial assistance. This misses the point (or sees it all too well). Selective financial assistance is demand determined and not cash limited. If Mr. Younger wants to exceed the guidelines, he should pay for it - not the Treasury. I recommend that you make this clear.

This is particularly important since the Chief Secretary has now written to Departments (Flag B) to generalise the decision which you made in the Oy Kaukas case, saying that his approval for assistance going beyond the cost per job or public sector contribution criteria will only be given if the spending Departments agree to reduce their provision for cash limited expenditure by the amount by which the proposed grant exceeds the maximum permitted by the guidelines.

Agree:

- Yes*
MF
- (i) to write confirming the stricter interpretation in the Oy Kaukas case;
 - (ii) to write to Departments supporting the Chief Secretary in a general application of the same rule?

25 October 1985

DNS
DAVID NORGROVE



NEW ST. ANDREWS HOUSE
EDINBURGH EH1 3SX

cc P. Mowison

David Norgrove Esq
10 Downing Street
LONDON
SW1A 2AA

Prin Minutes

23 October 1985

23/10

Dear David,

My Secretary of State has asked me to record his gratitude for the Prime Minister's agreement to the offer of assistance of £12 million to Oy Kaukas Ab, recorded in your letter to me of 17 October. The offer has been made and my Secretary of State is hopeful that this very important project will be secured.

I confirm that my Secretary of State is willing, if the company proceed with the project, to transfer £4 million from the cash limited part of his Industry programme, to provide additional provision for selective financial assistance. This assumes, of course that the Chief Secretary's original requirement, that the expenditure be covered from baseline provision for selective financial assistance, remains impossible to meet.

I am copying this letter to Richard Broadbent (Chief Secretary's Office), John Mogg (Department of Trade and Industry) and Michael Stark (Cabinet Office).

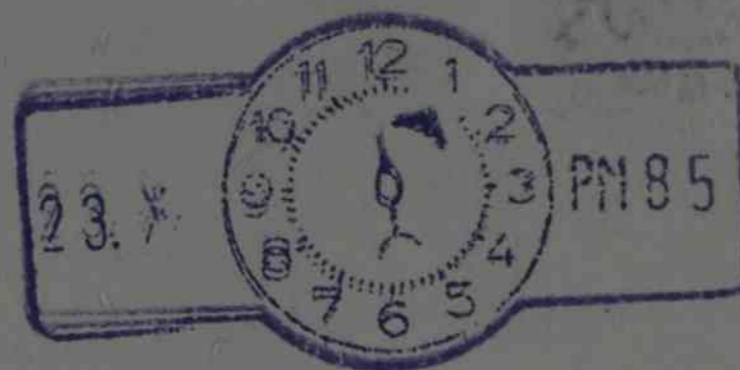
Yours sincerely,
John S. Graham

J S GRAHAM
Private Secretary

REGIONAL POLICY

REVIEW

PT





10 DOWNING STREET

File
JJA
36
cc: CS/
DI
CO
cc P. Morrison

From the Private Secretary

28 October 1985

OY KAUKAS

The Prime Minister has seen your letter to me of 23 October.

The Prime Minister's decision that £4 million of the assistance for Oy Kaukas should be found from the cash limited part of the Scottish Industry programme was not taken on any assumption that the resources could not be found from within the base line provision for selective financial assistance. In the Prime Minister's view, if the Secretary of State for Scotland believes this project is sufficiently important to justify exceeding the cost per job guidelines, the extra resources should be found from cash limited Scottish programmes, whatever the position on the base line provision for selective financial assistance.

I am copying this letter to Richard Broadbent (Chief Secretary's Office), John Mogg (Department of Trade and Industry) and Michael Stark (Cabinet Office).

(David Norgrove)

John Graham, Esq.,
Scottish Office.

ECU



SRW
cc P. Morrison

10 DOWNING STREET

From the Private Secretary

4 October 1985

PROPOSED LINWOOD PULP AND PAPER PLANT

The Prime Minister has seen your Secretary of State's minute of 1 October and the Chief Secretary's minute of 3 October.

Your Secretary of State explained the great importance he attaches to securing the Oy Kaukas Ab investment for Linwood. The Prime Minister agrees that assistance of £12million may be offered to the Company, provided your Secretary of State is willing to find £4million of this from cash limited Scottish expenditure.

I am copying this letter to Richard Broadbent (Chief Secretary's office), John Mogg (Department of Trade and Industry) and Michael Stark (Cabinet Office).

(DAVID NORGROVE)

John Graham, Esq.,
Scottish Office.

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ECh

CONFIDENTIAL file BM



10 DOWNING STREET

From the Private Secretary

28 October 1985

SECTION 7 ASSISTANCE

The Prime Minister has seen the Chief Secretary's letter of 24 October to your Minister. She agrees very strongly that cases where the guidelines on cost per job and public sector contribution are exceeded should be very rare. She also supports the Chief Secretary's decision to make Treasury approval for such cases conditional on a reduction in the Department's provision for cash limited expenditure equivalent to the amount by which the proposed grant exceeds the maximum permitted by the guidelines.

I am copying this letter to Richard Broadbent (Chief Secretary's Office), John Mogg (Department of Trade and Industry), John Graham (Scottish Office) and Colin Williams (Welsh Office).

(David Norgrove)

Malcolm McHardy, Esq.,
Department of Trade and Industry

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26



Treasury Chambers, Parliament Street, SW1P 3AG
The Hon Peter Morrison MP
Minister of State for Industry
Department of Trade and Industry
1 - 19 Victoria Street
London
SW1E 6RB

24 October 1985

Dear Peter,

SECTION 7 ASSISTANCE

Thank you for your letter of 4 October about Section 7 assistance to Goodyear. *will request of 'd.*

I welcome your undertaking not to bring forward cases outside the guidelines unless you think that they can be properly defended as exceptional in regional policy terms. But I am very concerned at the number of requests for exceptional treatment put to me in the short time I have been Chief Secretary, the latest from Paul Channon in connection with the Guangdong Nuclear Project. *will request of 'd.*

As I explained in my minute of 3 October to the Prime Minister in connection with George Younger's proposal to offer grant to Oy Kaukas, I do not believe that we can accept a situation in which the guidelines are repeatedly exceeded. The risks to the job-related objective of our new regional assistance policy are clear. There are also considerable dangers for control of public expenditure.

The proposals we have yet to discuss on limiting of commitments under Section 7 of the Industry Act may in due course exert control over the expenditure, but any proposals that we agree will take time to implement and it will be some time before we know how effective they are. Furthermore, commitment limiting will not deal with the need to achieve the job-related policy objective.

Under the guidelines all cases which exceed the two quantifiable criteria - cost/job and public sector contribution - come to the Treasury for approval. I hope that these cases will be rare in future, and I shall need a great deal of

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convincing that other factors make it essential to give assistance breaching the guidelines. Further, I think it is only right to let you know that in such cases I propose in future to make my approval (and that of my officials) conditional on a reduction in the department's provision for cash limited expenditure, equivalent to the amount by which the proposed grant exceeds the maximum permitted by the guidelines. This procedure reflects the Prime Minister's decision in the Oy Kaukas case. My officials will provide more detailed guidance to Departments on how these arrangements will be applied.

I am copying this to the Prime Minister (in view of her involvement with the Oy Kaukas case) and to Leon Brittan, George Younger and Nicholas Edwards.

Younger,
JH

JOHN MacGREGOR

