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CABINET

MINISTERIAL COMMITTEE ON ECONOMIC STRATEGY

INVERGORDON SMELTER

Note by the Central Policy Review Staff

1. In his paper E(82)19 the Secretary of State for Scotland makes a case for a new subsidy for the Invergordon smelter on social and political grounds. In the CPRS's view this proposal should be considered against the background of:-

(a) the December decision not to subsidise BACO to continue the smelter;

(b) the economic case for keeping the smelter in operation; and

(c) the wider implications of giving a subsidy.

2. In December it became clear that BACO operation of the smelter could only be continued if the Government were prepared to accept a liability of at least £16m a year until the year 2000, and possibly more if Hunterston B costs rose excessively. This was not acceptable, not least because of the very high subsidy per job involved.

3. The subsidies can be measured on three alternative bases:-

(i) E(82)19 is based on NCB export prices (£25/30 per tonne), but since NCB exports are heavily loss-making this is only relevant in the short term;

(ii) An alternative is to take the domestic price of NCB coal (about £38 per tonne).

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(iii) A third basis, and in the CPRS view the most appropriate, is to compare the price of electricity proposed (1.0 - 1.2p per unit) with the price of electricity to other heavy users (say 2.3p as from next month)

£m	NCB export prices (i)	NCB domestic prices (ii)	Electricity prices for heavy users (iii)
Subsidy to Invergordon	7.5	17	19-23
Subsidy to Lynemouth	15.0	23	24-28
Total subsidy to Alcan	22.5	40	43-51

4. Unlike BACO, Alcan would accept a five-year review of such arrangements in the context of a 10-15 year contract. This might allow some reduction in the subsidy after five years if aluminium prices had risen substantially. However, once the decision is taken to enter into a new contract, to preserve employment at Invergordon, the Government will be in a weak position to negotiate any substantial changes.

5. The basis of the Invergordon proposal is that marginal coal is available from pits which the NCB cannot yet close, while the SSEB has excess capacity. The NCB in Scotland face a particular problem in the next three years or so while the Peterhead power station uses the gas subsequently intended for Mossmorran. But a long term contract based on helping the NCB over this problem would amount to prolonging the inefficiency which the Government wants the NCB to eliminate as soon as practicable. New legislation may well be required to allow the NCB to enter into a new discriminatory contract with a customer which is not in the NCB's own commercial interest (the problem of discrimination made it difficult to envisage adopting the proposals for large energy users put to MISC 56 last year).

6. It will be difficult to limit this major subsidy to Alcan. In 1982-83 as Dungeness comes onstream the Anglesey smelter is likely to become liable to greatly increased charges. Subsidies to Alcan at Invergordon and Lynemouth would make it very difficult to avoid giving the same order of subsidy to Anglesey.

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7. But the implications are wider than this. A new power contract would substantially increase the pressure to make similar concessions to other high energy users, far beyond the limited load management scheme currently under consideration by Ministers. This in turn would put further pressures on the entire price structure, domestic as well as industrial.

8. The present basic policy on electricity pricing is that it should be in line with the long run marginal costs of production. There may be a case for modifying this in the light of careful study of its implications on energy intensive industries overall. However, to do so piecemeal would risk undermining this policy completely.

9. The CPRS believe that the burden of high electricity prices is an important question which the Government needs to examine carefully. But if the pressure is to be alleviated the aluminium industry is not the place to start. Because of the very high energy requirements required in aluminium smelting future growth of the industry will be in countries with access to hydro-electricity or other sources of cheap energy, such as Canada, Norway, Venezuela and the Middle East. Although aluminium smelting gets highly preferential treatment in a number of countries, major industrial countries such as Japan and Germany are already large net importers of primary aluminium and this trend is likely to continue. Secondary aluminium processors should have no difficulty in securing supplies, even if there were no major UK primary producers. This is in contrast with other energy-intensive industries in the UK, such as chemicals and electric arc metal manufacture, where there may be stronger reasons for retaining primary capacity in the UK in order to preserve the opportunities for downstream processing and total value added to the UK economy.

10. In the view of the CPRS, proposals based on supplying Invergordon and Lynemouth at a cost of 1-1.2p per unit would be very expensive, in aggregate and in cost per job, and would have very serious wider repercussions. Our conclusion is there is not a sound case for these proposals on economic grounds.

Cabinet Office
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