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E(82) 10th Meeting COPY NO 66

CABINET

MINISTERIAL COMMITTEE ON ECONOMIC STRATEGY

MINUTES of a Meeting held at
10 Downing Street on
TUESDAY 23 MARCH 1982 at 11.00 am

PRESENT

The Rt Hon Margaret Thatcher MP
Prime Minister

The Rt Hon William Whitelaw MP
Secretary of State for the Home Department

The Rt Hon John Biffen MP
Secretary of State for Trade

The Rt Hon David Howell MP
Secretary of State for Transport

The Rt Hon Leon Brittan QC MP
Chief Secretary, Treasury

The Rt Hon Baroness Young
Chancellor of the Duchy of Lancaster

The Rt Hon Nigel Lawson MP
Secretary of State for Energy

The Rt Hon Norman Tebbit MP
Secretary of State for Employment

The Rt Hon Cecil Parkinson MP
Paymaster General

THE FOLLOWING WERE ALSO PRESENT

The Rt Hon Francis Pym MP
Lord President of the Council

The Rt Hon George Younger MP
Secretary of State for Scotland

The Rt Hon Nicholas Edwards MP
Secretary of State for Wales

The Rt Hon Lord Mackay of Clashfern QC
Lord Advocate

The Rt Hon Michael Jopling MP
Parliamentary Secretary, Treasury

Mr John MacGregor MP
Parliamentary Under-Secretary of State
Department of Industry

Mr J R Ibbs
Central Policy Review Staff

SECRETARIAT

Sir Robert Armstrong
Mr P L Gregson
Mr D J L Moore

SUBJECT

INVERGORDON SMELTER

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INVERGORDON SMELTER

Previous Reference: E(82) 7th Meeting

The Committee considered a memorandum by the Secretary of State for Scotland (E(82) 31) on a new power contract which might be offered to firms interested in reopening the aluminium smelter at Invergordon. Their discussion and conclusions reached are recorded separately.

Cabinet Office

24 March 1982

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CABINET

MINISTERIAL COMMITTEE ON ECONOMIC STRATEGY

LIMITED CIRCULATION ANNEX
E(82)10th Meeting Minutes
TUESDAY 23 MARCH 1982 at 11.00 am

CONFIDENTIAL

INVERGORDON SMELTER
Previous Reference: E(82)7th Meeting

The Committee considered a memorandum by the Secretary of State for Scotland (E(82)31) on a new power contract which might be offered to firms interested in reopening the aluminium smelter at Invergordon.

THE SECRETARY OF STATE FOR SCOTLAND said that, of the two main possibilities which had emerged from the Committee's previous discussion, he now considered that a contract based on coal prices would be insufficiently attractive to potential operators and would involve a form of subsidy open to challenge by the European Commission. Instead, he recommended that the contract should be regarded as related to the output of hydro-electric power stations in the North of Scotland. It would be necessary to bridge the gap between the starting price of around 1.2p a unit for power which a new operator would require for a viable aluminium smelter and the minimum price of about 2.5p a unit which the North of Scotland Hydro Electric Board (NSHEB) could justify in relation to their short-run costs. Since the smelter would not absorb power equivalent to the full output of the hydro system, concessions should also be made available to other industrial consumers in the area with substantial electricity requirements. The gross cost of concessionary prices on this basis would be about £25 million a year although, in his view, the net cost would be only about £7 million if credit were taken for increased revenue for the National Coal Board and for British Rail and for reductions in unemployment and other benefits. The contract would be open to review after 5 years and in that respect it would be

better than the proposals which had been considered for enabling the British Aluminium Company to keep the smelter open. It would be necessary to introduce a Bill as soon as possible to enable him to designate by Order those areas and categories of consumer to which the requirement on the NSHEB to avoid undue preference or undue discrimination would not apply. It was proposed that the Board should be compensated for the annual costs of the price concession by the writing-off of loans, and it would probably be necessary to provide for this in the Bill. The proposals would in principle be open to challenge by the European Commission, although in practice they could probably be persuaded to accept them. In his view the proposals could be regarded as particular to the needs of the Highlands and, as such, would not lead to repercussions. It was widely known in Scotland that there were potential operators who would be willing to reopen the smelter if the Government took steps to offer a suitable new power contract. It was also known that the two other aluminium smelters, at Lynemouth and at Anglesey, benefited from favourable power contracts. There were no other industries which could be moved to Invergordon and the credibility of the Government's concern for Scotland turned crucially on its willingness to enable the smelter to be reopened. He accordingly invited the Committee to approve the proposals set out in his memorandum.

In discussion the following were the main points made -

a. There was no commercial case for a subsidy at the level proposed and for an indefinite period; it was unrealistic to think that the contract could be terminated or substantially revised after five years. Although there were a number of firms willing to consider reopening the smelter this was only because they assumed that a large subsidy would be provided to enable them to do so. Increases in British Rail and National Coal Board revenues would not necessarily lead to off-setting public expenditure savings.

b. In his previous paper, E(82)19, the Secretary of State for Scotland had pointed out that because the individual hydro stations did not have the water resources to run continuously they were best suited to peak load rather than the base load required by the Invergordon smelter. It followed that it was very difficult to try to defend the present

proposal on the grounds that the natural resources of the Highlands were being used to meet the economic needs of the Highlands; under the proposed power contract the Invergordon smelter would be drawing power from the Scottish generating system as a whole. To the extent that cheaper electricity was made available to the smelter - either by hypothecation or, if it were practicable, sale or lease of a hydro power station - other consumers would have to pay more for their electricity, unless subsidies were paid to avoid this.

c. A ring fence could not be drawn round the proposed new power contract in a way which would prevent repercussions. Alcan would look for subsidies on a similar scale in support of their aluminium smelter at Lynemouth and so would the operators of the smelter in Anglesey if their present power contract was revised or terminated. Other energy intensive industries, some of which were also in areas of high unemployment, would argue that a cheap source of power should be dedicated for their use. Some of them could further argue that they happened to be located near to sources of cheap energy.

d. Although the proposed Bill might be short it would be controversial because of the costs of the subsidy and of the repercussions for other industries. It would be seen as representing a break with the industrial and economic policies which the Government had consistently pursued over the last three years. It would be criticised by a number of Conservative Members of Parliament. It would be very difficult to explain and defend publicly, particularly with reference to the arguments which had led the Government not to intervene at the end of 1981 to stop the British Aluminium Company closing the smelter.

e. A better solution would be to increase the grants available to the Highlands and Island Development Board (HIDB) for assisting the Invergordon area. It might be possible to stimulate more activity, and employment, in oil related industries. In principle it would be possible for the HIDB to use grants to enable the smelter to be reopened but in practice it would be very difficult for them to do so without running into the objections applying to the present proposal.

THE PRIME MINISTER, summing up the discussion, said that, while the Committee recognised the acute social and political difficulties resulting from the closure of the Invergordon smelter, there were overriding disadvantages in the new power contract proposed by the Secretary of State for Scotland. For the reasons put foward in discussion, it would not be possible to draw a ring fence around the arrangements so as to justify refusing similar subsidies to other energy intensive industries in areas of high unemployment. Although a wide range of opinion in Scotland appeared to favour a solution based on the use of hydro-electric power, it was doubtful whether it was fully understood that the Invergordon smelter could not in practice rely on power supplies solely from hydro-electric sources or that cheaper electricity for Invergordon meant more expensive electricity for other consumers, unless substantial subsidies were provided. The Secretary of State for Scotland, in consultation with the Secretary of State for Energy, should prepare a paper demonstrating on technical, economic and other grounds the impracticability of a solution based on hydro-electric power; this could then be used for explaining why the Government could not adopt this approach. In consultation with the Chief Secretary, Treasury, and other Ministers as necessary, the Secretary of State for Scotland should also consider the case for increasing the grants available to the HIDB for use in assisting the Invergordon area. Subject to consideration of the European Community constraints, such a direct grant, given to meet a particular regional need, would be easier to defend than a new power contract. In the meantime, if questions were asked about the Government's intentions for Invergordon, it could be indicated that the studies were continuing.

The Committee -

~~1. Agreed that a new power contract, as proposed in E(82)31, could not be offered to encourage the reopening of the aluminium smelter at Invergordon.~~

1. ~~2.~~ Invited the Secretary of State for Scotland, in consultation with the Secretary of State for Energy, to circulate a memorandum summarising the arguments which could be used publicly against basing a power contract for the Invergordon aluminium smelter on hydro-electric power supplies.

2. ~~3.~~ Invited the Secretary of State for Scotland, in consultation with the Chief Secretary, Treasury, and with other Ministers as necessary, to put forward for consideration by the Committee proposals for an increase in the grants available to the Highlands and Islands Development Board for stimulating investment and employment in the Invergordon area.

Cabinet Office
24 March 1982