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CABINET

MINISTERIAL COMMITTEE ON ECONOMIC STRATEGY

INVERGORDON SMELTER: REMEDIAL MEASURES

Memorandum by the Secretary of State for Scotland

1. At the meeting of the Committee on 23 March (E(82)10th Meeting) I was invited to put forward for consideration proposals for an increase in grants available to the Highlands and Islands Development Board (HIDB) for stimulating investment and employment in the Invergordon area. The following paragraphs consider the scope for such remedial measures and their implications for the overall response which the Government could offer on the Invergordon issue. I have prepared this paper after discussion with the Secretary of State for Energy.
2. When the smelter closure was announced I indicated, in recognition of the consequences for employment and economic activity in the Invergordon area, that I would increase HIDB's allocation by a total of £10m over the three years 1982/83 to 1984/85 to allow the Board to undertake special measures to provide new employment opportunities in the area. I also invited HIDB and Scottish Office officials jointly to undertake a study aimed at identifying the extent of the difficulties caused by the closure, determining the factors relevant to the re-opening of the smelter, evaluating other measures to mitigate the effects of the closure and drawing up a programme of action.
3. The Report puts forward a number of positive recommendations to assist the area. These are being followed up but they are all modest in relation to the problem. The report concludes that the prospects of attracting significant new industrial development to the area in the foreseeable future are slight, and that the level of employment is more likely to decline further over the next few years than to recover. This conclusion is underlined by indications which have emerged since the study was completed of a real risk of substantial redundancies at Highland Fabricators Ltd, the platform constructors, at Nigg which is close to Invergordon. The company currently employs about 2,500 and is now working on its remaining order, due for completion by the Spring of 1983. Despite its successful track record the future for the yard looks uncertain as the demand from the UKCS for the heavy steel jackets which it is best suited to build is expected to decline.

4. Against this background I have concluded that a further increase in HIDB's financial provision would have little prospect of improving the Board's chances of creating new jobs in the Invergordon area. The financial incentives which the Board can offer are already equal to the best available in the UK, and further improvement is constrained by EC regional aid ceilings. The Board would in fact have considerable difficulty in spending locally and substantial extra allocation of resources, and the granting of extra funds would be seen as an empty gesture.

5. The joint Report argues strongly that the only sure way to reduce the high levels of unemployment in the area would be to re-open the smelter, and that this would require power to be supplied at a price which would allow the smelter operation to be viable. The only way in which very substantial funds allocated to HIDB could be effective in stimulating employment in the area would seem therefore to be by permitting the Board to subsidise the smelter.

6. I have considered this option carefully because we would be in a very difficult position if I have to say publicly that I am unable to put a package together which can be offered to potential operators. At the very least I must be able to say that I have tested the market. The political consequences of refusing any concession on power prices for the smelter would be disastrous, given the many statements which I and other Ministers have made about the Government's intentions and the meeting which the Prime Minister's had with the Council and Invergordon workers. E(82)/387 sets out the arguments which we could deploy in public against the various power contract options which we have discussed in recent weeks but I do not think our supporters in Scotland will find them very persuasive. The political pressure on us to enable the smelter to reopen remains intense.

7. Export Priced Coal and HIDB Grant Option

I therefore propose that we re-consider the export priced coal option originally put forward by the Secretary of State for Energy, and link it with assistance from the HIDB. E(82)31 described an option based on the supply of coal at the export price for Scottish coal or coal of similar quality but dismissed it because it was considered that although a coal supply at this price would bridge a substantial part of the gap, the resulting electricity price would still be too high in present market conditions to make the smelter operation viable. However, as the HIDB's enabling Act would not rule out HIDB offering a direct grant to an operator, this problem might be capable of being overcome in this way. The argument that the offer would only be for five years is still extant and may prove a serious stumbling block to Companies interested in taking over the plant but to follow this option would at least enable us to put an offer to a potential operator. The HIDB has wide powers to give financial assistance to industry or commerce and I can see nothing to prevent the Board making an annual payment of grant to a smelter operator to defray electricity costs. The arrangements which are currently in force and which are approved by Treasury would have to be altered. There would certainly be difficulties in obtaining approval from the Commission but no more than have been recognised in E(82)31. The total gap between the internationally viable electricity price for aluminium smelting and the normal price on bulk supply which would be offered by the Electricity Board would be about £20m. Half of this gap would be met by the supply of coal at the export price and this would leave the HIDB to meet the remainder by a grant in support of the operator of about £10m a year. The effect of this on the Exchequer would be offset by increased tax and reduced unemployment benefit of about £5m.

8. EEC and Legislative matters

Any additional grants to the HADB which exceeded regional aid ceilings would need to be notified. A direct operating subsidy paid by HADB to the smelter operator would be a state aid as defined in Article 92(1) (ie an aid which distorts or threatens to distort intra Community competition) and would have to be notified to the Commission in accordance with Article 93(3). It would by no means be easy to obtain the Commission's approval, but it might be possible to justify the aid under Article 92(3)(a) (promotion of economic development in an area of serious under-employment). The extent to which NCB can offer to reduce prices is subject to ECSC rules. We should need to be satisfied that no breach of NCB's duties in the matter of undue preference would be involved.

9. Treasury View

Treasury officials note that the level of subsidy required to keep the smelter open is uncertain, but of the same order of magnitude, about £20m per annum, as previous options which have been considered and rejected by Ministers. They point out that about half of this subsidy goes towards providing the smelter with coal at below cost. This element of the subsidy is not a direct addition to public expenditure because the NCB would otherwise have to export the coal for the same net proceeds. But whilst coal is in surplus in the short term, the Government's policy is for the NCB to bring supply and demand into balance in the medium term. By then exports will have been phased out, so that in the view of the Treasury the coal export price option cannot form the basis for a longer term solution. The other half of the subsidy is provided by the HADB as a current grant towards the operating cost of the smelter, and is a direct addition to public expenditure. The Treasury believe that a solution along these lines would set a dangerous precedent. Other large electricity users, particularly the smelters at Lynemouth and Anglesey, will expect similar coal price concessions and probably a grant in the case of the smelters.

10. Recommendations

Since the export priced coal option has the following advantages, ie:-

- (a) it helps reduce the amount of surplus coal production and makes use of coal for British industry which would otherwise be exported;
- (b) it uses capacity on the Scottish Electricity Boards' system which would otherwise be unused;
- (c) it maintains traffic on British Rail's network in Scotland;
- (d) it reduces unemployment in an extremely sensitive area;
- (e) the offer would be limited to five years;
- (f) no legislation is needed;
- (g) EEC problems may not be insurmountable; and
- (h) it minimises the danger of repercussive effects on industry in general,

I recommend that officials should have urgent discussions with the NCB and Scottish Electricity Boards and draw up a detailed proposal based on a direct subsidy and cheap coal which would be cleared by the Commission and offered to potential smelter operators.

G.Y.

Scottish Office
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