CONFIDENTIAL

Prime Minister

DRN 23/4.

MR NORGROVE 22 July 1986

CORNISH TIN: THE RTZ PROPOSAL

Despite the employment sensitivities, there are strong arguments for rejecting the DTI proposal for £15m grants and up to £10m guaranteed loans to keep open the RTZ tin mines. Firstly, the commercial viability of the project is highly questionable and, as currently structured, would leave the Government extremely exposed in the event of failure. Secondly, the granting of what, in these circumstnaces, would effectively be a subsidy for uneconomic operations, is not an efficient use of government funds and would create a dangerous precedent for government intervention in other declining industries.

Commercial Viability

The questionable viability of the Cornish tin mines reflects their relatively high production costs on a world scale - currently around £6,000-6,500 per tonne against a world range from under £4,000 per tonne (eg Brazil) to a few marginal mines at over £8,000 per tonne. The RTZ proposal envisages capital investment of £31.2m over the next 5 years to reduce the cost of production at Wheal Jane and South Crofty to £5,000-5,500 per tonne. This investment only has a commercial return under the assumptions put forward by RTZ that the price of tin rises from its current level of £3,910 per tonne to at least £6,500 per tonne in the early 1990s. In a free market, this implies sufficient demand to re-employ most of the existing high cost world capacity, with no significant development of new lower cost capacity in the interim.

Projecting the future price under these assumptions is obviously highly risky. A slightly less optimistic scenario which DTI economists accept as quite plausible (with the price below £6,000 per tonne until 1994) produces results which are clearly unacceptable. Given these risks, the most telling point is RTZ's apparent lack of confidence in their own proposition, evidenced by the fact that:

1. They have made it clear to DTI that, in the absence of grants at the level requested (a minimum 50% of the expenditure), they would have no hesitation in closing the mines.

2. Their condition for proceeding is that the capital grant is loaded into the first two years, with an option for them to withdraw in 1988 if the viability then looks questionable. In this way their total exposure up to the review date is between £7m and £9m against a potential Government exposure (including loan guarantees) of £25m.

The absence of tight conditions for the project review in 1988 is particularly concerning since, in adverse market circumstances, it opens up the danger of the company applying continuing 'De Lorean' type pressure to raise the Government aid component to maintain employment and 'protect the prior investment'.

Precedent for Government Subsidy

If the commercial viability of the project is questionable, any Government aid must be viewed as primarily an employment maintenance measure. As such, the cost of the grant is not much higher than the gross cost of employing an equivalent number of people on the community programme for 5 years. However, if the project fails, there will have been much less contribution to permanent employment than a scheme aimed at retraining the long-term unemployed or supporting new enterprise development. Furthermore, it is not clear why this particular area should get special treatment outside the normal budget for employment creation measures when factories and facilities are continuing to close in other high unemployment areas.

In addition, if the measure is seen as subsidising existing, non-viable jobs as opposed to stimulating new enterprise, the precedent could weaken the Government's whole argument on the need for restructuring the economy out of non-productive activity - and make it more difficult to hold the line, for example, on closing marginal coal pits where similar arguments could be made. To break the PES limits in such a situation would make the precedent even more damaging.

Conclusion

This project can only be backed with confidence in a situation where the agreement with RTZ has a substantially low grant element and a higher exposure for RTZ to underline their own management commitment. Unfortunately, DTI have made it clear that RTZ are unlikely to renegotiate.

In these circumstances, the Government should reluctantly turn down the proposal and position the closure as the inevitable consequence of a long run decline in Cornish mining - where employment has dropped continuously from a peak of 18,500 in the 1870s to only 1,500 before these closures.

Norman Blackwell

NORMAN BLACKWELL

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CHIEF SECRETARY TO THE TREASURY

Treasury Chambers, Parliament Street, SW1P 3AG

The Rt Hon Paul Channon MP
Secretary of State for Trade and Industry
Department of Trade and Industry
1 - 19 Victoria Street
London
SW1E 6RB

23 July 1986

Dear Paul,

ASSISTANCE TO RTZ's CORNISH TIN MINES file with DEN.

Thank you for your letter of 16 July seeking my agreement to Section 8 assistance to develop RTZ's tin mines in Cornwall. My officials have now discussed the details of this case with yours. I have therefore considered your proposal both in relation to the points raised in your letter and the more detailed information which emerged from that meeting.

The prospective closure of the RTZ Mines clearly presents us with difficult political and presentational issues. But, it is precisely these type of difficult cases where we need to be sure that proposals for spending public money meet the agreed criteria. On the basis of the information available to me I cannot accept that the RTZ project fulfils the Section 8 (or, indeed, Section 7) criteria. The key areas of weakness seem to be in relation to the viability of the project and the national economic benefit to be derived from the investment of public money.

As far as viability is concerned, this depends crucially on the world price of tin. While there is a reasonable expectation that the price of tin will eventually have to rise, the precise timing and scale of any increase are extremely uncertain. I understand from discussions between our officials that there is agreement amongst them that the price forecasts on which the RTZ project are based are optimistic. The viability of the project is, however, very sensitive to the tin price. Thus, if prices were, on average, £500 lower than forecast (a fluctuation of only 10 per cent) then the project is only marginally viable. The RTZ project is therefore of very doubtful viability.

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This is underlined by the condition which the company have imposed on their participation i.e. the right to review the tin price and progress with the project at the end of 1988 and to withdraw from further investment at that point if the price does not match up to original forecasts. This means that the Government is being asked to bear practically the whole of the risk of this investment in the crucial period of uncertainty over the future of tin prices. My officials suggested to yours a reduction and/ or rephasing of the drawdown of the grants to match more closely the incidence of expenditure in line with the normal guidelines. I understand that RTZ were not prepared to accept any further risk exposure and would not agree. If RTZ were to decide to close down in 1988 then we would have effectively financed nearly the whole of RTZ's capital investment up to that point (some £21 million out of a total projected spend of £31.2 million up to 1990). Assuming the additional £5 million loan guarantee is called, the company's additional exposure at end 1988 would be only £4 million.

As far as national economic benefits are concerned, only if the top end of the range of price assumptions is achieved will there be <u>any</u> national economic benefits, valued at £3.1 million over the period 1986-2000. A 10 per cent across the board reduction in prices leads to a resource <u>loss</u> of £17.5 million.

There are no overriding industrial grounds for supporting the project. There is no strategic value to the metal, and the Cornish tin ores will remain in the country even if not used, and so will be available for future exploitation. I note in this connection that RTZ were prepared to reclaim Wheal Jane in 1980. So, provided that tin prices again reach levels which make Cornish mining economic, there is no reason why the ore should not eventually be exploited.

Against the above background, it seems clear that the project does not meet the criteria governing the use of Section 8 assistance. I understand that your officials have admitted as much in their meeting with mine.

This leaves the regional considerations on which you place considerable emphasis in your letter. I accept that the employment consequences of closure of these two mines are very significant as far as Cornwall is concerned. However, I would emphasise that they are no greater than in respect of the number of other very difficult decisions that we have faced in recent years. And even on the most optimistic scenario the cost per job safeguarded exceeds the Section 7 limits: a less than totally successful project would lead to cost per job figures double the agreed limits.

You say in your letter that you are unable to meet the costs for proposed assistance within your existing PES provision for Section 8. For the reasons set out in my letter of 11 July, I cannot accept this. If it is decided to give some measure of assistance to RTZ then that project must either displace other Section 8 cases or be financed from savings elsewhere on your cash limited votes.

I am copying this letter to the Prime Minister, Geoffrey Howe, John Biffen, John Wakeham and to Sir Robert Armstrong.

Yours ever,

JL

JOHN MacGREGOR

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The Rt Hon Paul Channon MP
Secretary of State for Trade and Industry
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NBPM.

21 July 1986

Dear Paul,

ASSISTANCE TO RTZ'S CORNISH TIN MINES

I have seen your letter of 16 July to John MacGregor and I hope that his reply to your proposal is favourable. As I mentioned at my meeting with you, it would greatly help if RTZ could provide some assistance to develop local enterprise and so cushion those redundancies which do occur. The clear need is to provide small loans to new businesses as Shell do in some areas. This does not require large scale finance but the Government does not provide such small loans under present schemes.

I would hope that this could be raised with RTZ before the present negotiations are complete.

I am copying this letter to the Prime Minister, Geoffrey Howe, John Biffen, John MacGregor, John Wakeham and Sir Robert Armstrong.

Yours,

David

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Secretary of State for Trade and Industry

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16 July 1986

The Rt Hon John MacGregor MP
The Chief Secretary
HM Treasury
Parliament Street
LONDON
SW1P 3AG

(NORMAN BLACKWELL)
Any PW comments
by tomorrow please (18/7).

Dear John,

ASSISTANCE TO RTZ's CORNISH TIN MINES

FILE WITH DRW

As foreshadowed in my minute of 3 July to the Prime Minister, RTZ have put forward alternative proposals for support for their tin mining operations in Cornwall. I am now seeking your agreement to make an offer to RTZ of grant assistance of up to £15 million, together with a guarantee on loans of up to £10 million, to develop RTZ's tin mines in Cornwall.

In asking you to agree to this exceptional level of support, I have of course taken into account the points you raise in your letter to me of 11 July. RTZ's revised project will result in profitable tin mining operations in Cornwall in the 1990's, on reasonable assumptions about the recovery of the tin price from its current depressed level. If, as I expect, the project is successful, it will provide 860 jobs for a grant of £15 million. This needs to be compared with the Exchequer costs over the next five years of £21 million if the RTZ mines both close. I know the dangers of using Exchequer costs in this way, but the Select Committee on Trade and Industry have repeatedly emphasized the point and this was echoed by Cornish MPs in the debate in the House on 7 July. Alternative employment will be difficult to find, if the RTZ mines close, but I would not be recommending support for this project if RTZ and my Department did not consider that there were good prospects for viability once the present period of uncertainty over the tin price is past.

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I set out below a description of the project and the case for support: my officials are ready to discuss the project in more detail with your officials.

The project is for RTZ's Wheal Jane mine to continue in operation and for South crofty mine to cease commercial production but to undertake a development programme with a view to starting up full production again in 1991. This project would secure 640 jobs between now and 1990 and potentially a total of 860 jobs from 1991 onwards.

The total capital required by the project would be £31.2m by 1990, and the company are seeking once and for all grant assistance of £15m and HMG loan guarantees of a minimum of £5m, and a maximum of £10m. The additional loan of £5m, and therefore HMG's exposure to a guarantee, would be drawn down at RTZ's option if their tin price forecasts for 1987 and 1988 (£4,500 per tonne) prove optimistic.

The commitment of RTZ's management to this project is impressive and we have little doubt that the company will be able to achieve the cost reductions sought and that, barring reductions in the forecast price of tin (which is where the risk lies), the project will be successful. Furthermore, under the ownership of RTZ the mines have access to funds and it is reasonable to assume that they would be protected against future short-term price falls which might arise.

This assistance cannot all be offered under Section 7 of the Industrial Development Act because Wheal Jane is just outside the Assisted Area. Hence our proposal to use the powers in Section 8.

We have considered the application carefully and have concluded that the regional, social and wider national case for providing the assistance is strong. The Select Committee stressed this also in their reports on the tin crisis. The large majority of tin miners concerned live in the Redruth-Camborne area, which like much of Cornwall has stubbornly high long-term male unemployment.

If the RTZ mines close, one man in every three in that travel-to-work area would be out of work, a rise of two fifths. The figure in Cornwall overall would rise from 21 per cent to 25 per cent. Only a few of the miners would be able to find different jobs locally and the costs in human and financial terms would be high and persistent. Elsewhere Cornish tin provides secure feedstock for RTZ's smelter on Humberside (another area of high unemployment) at a time when the smelter's other sources of supplies are at risk.

I would add that if skills in hard rock mining can be kept alive in

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Cornwall, new metalliferous projects will be able to get going more easily when times are better, as there will be a pool of skilled workers to draw on.

As expected, the assistance to RTZ would be outside normal guidelines, and so require Treasury approval. Also, as I warned in my minute to the Prime Minister of 3 July, I cannot accommodate this support within my Department's budget. I realise how difficult it will be for you to agree to additional funds in advance of the PES round but the timing of RTZ's redundancy notices means decisions cannot wait. My total provision for Section 8 support is only about £10m a year and you will know from my PES bids that I have already offered up all my available offsetting savings. I cannot therefore proceed with an offer to RTZ unless you can agree to provide an additional £5m in 1987/88 and £10m in 1988/89. You will readily appreciate the political difficulties the Government would face if RTZ's application was turned down for budgetary reasons, when it was public knowledge that the Government was prepared to offer £50m - from the Contingency Reserve - to rescue the ITC. I also need your authority to enter into the loan guarantees of a minimum of £5m which could rise to £10m depending upon the price of tin. I should add that the approval of Parliament and possibly the EC Commission will also need to be sought.

In short, the tin mines in Cornwall have a high profile politically and the decision we make will be widely reported and commented upon, either favourably or unfavourably.

I should be grateful therefore if you would approve the proposed offer to RTZ and agree that the amount required should come from central funds, using contingency provision if necessary.

May I please have your reply as soon as possible and preferably by 21 July so that we can complete negotiations with RTZ in time before their workers' redundancy notices expire on 31 July.

I am copying this letter to the Prime Minister, Geoffrey Howe, John Biffen, David Young, John Wakeham and Sir Robert Armstrong.

Yours,
Paul

JF2BOL

PAUL CHANNON

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