CONFIDENTIAL

THIS DOCUMENT IS THE PROPERTY OF HER BRITANNIC MAJESTY'S GOVERNMENT

E(80)67
11th July 1980

COPY NO 55

CABINET

MINISTERIAL COMMITTEE ON ECONOMIC STRAGEGY

STRATEGY FOR COAL

Memorandum by the Secretary of State for Energy

Colleagues may find it helpful for our discussion on the Public Expenditure Survey if I set out my thinking on our strategy for coal

The Financial Strategy

2 Last October E Committee agreed a financial strategy for the NCB involving the complete withdrawal of Government operating grants by 1983/84. The agreed figures for grants, and for total external finance are:

	Actual	1979 survey prices			
	1979/80	1980/81	1981/82	1982/83	1983/84
Operating grants	192	135	109	28	--
External finance	709	613	570	480	375

The outturn EFL for 1980/81 has already been fixed at £834m to allow for general inflation. The figures for later years will also have to be revalued for the same reason.

CONFIDENTIAL

Recent developments

3 Events since the strategy was settled have made it more stringent than we then thought. In particular, demand is likely to be lower than we earlier expected because of the increasing difficulties of the BSC, and the effect of the economic recession on the demand of electricity. The higher price of oil has provided little relief since oilburn was already expected to be at a minimum in the markets which mattered most. Unless the Board take countervailing action every tonne of surplus production increases their cash requirements by about £40.

The future of the strategy

4 We always knew that the strategy would not be easy for the Board to achieve and, with the change in circumstances, it has become harder. It will be some time before we can be sure of the outcome. I am however convinced that we must persevere with our chosen course. To change, within the first few months, a strategy designed to last for 4 years would be, and would be seen to be, an over-reaction. If we are to succeed in the difficult task of putting the coal industry's finances right, we must above all show steadiness of purpose. Any suggestion of a change now would also have the most unfortunate effect on the NCB and NUM at a sensitive time.

Responsibility of the NCB and the Government

5 The essence of our strategy was always that within a stringent financial framework set by us, responsibility for managing the industry should rest with the NCB. Putting responsibility in its proper place is of the greatest importance. Moreover, if it became known that decisions on specific matters such as closures had been made by the Government and not the Board, it would be harder not easier to get them accepted by the industry. The Government's concern is that the strategy should be achieved. I have left the Board in no doubt that this is what we expect of them and that they must take the hard decisions that are needed. We have monthly meetings with them at Ministerial level, to which the Treasury are

also invited, at which we monitor their progress and exert such continuing pressure as may be needed.

Means of attaining the strategy

6 I have pressed the NCB on how they could offset the change in circumstances and keep within the strategy. The principal means available to them are set out in the annex. I would draw attention especially to the position on closures. More economic closures are clearly required and must make a major contribution to achieving the strategy. In the past moreover the Board may not have been sufficiently resolute in making them, although under pressure from my Department they have now produced a case showing closures at 2½m tonnes a year in total. But equally we must recognise that closures are a highly emotional issue for the NUM as their recent Conference again demonstrated. The Board must and will go faster than they have recently, but if they go too fast they could stir up opposition on a scale that would jeopardise all our policies on coal. There could be an especially difficult situation in South Wales.

Government policy

7 In deciding our own line on coal issues, we must I suggest recognise two principles. First, the achievement of the strategy is central to our policy. We must not deal with peripheral issues in a way that might jeopardise the strategy. Secondly, we must recognize that in holding the industry to the strategy, we are driving it as far as we safely can. To try to do more would run big risks with our policy, not just on coal but also, given the importance of the coal industry and the miners, on economic and industrial relations matters generally. We must bear this in mind in considering all major questions affecting coal. We should for example avoid forcing the NCB to sell ancillaries worth perhaps £20m in total (compared with operating grants now running at £200m a year which the strategy is designed to eliminate). Still more should we avoid imposing new major requirements on the industry additional to the strategy.

The Investment Programme

8 I attach great importance to maintaining the NCB's investment programme. Cuts in investment would be contrary to our general policy, on which we have laid stress time after time, of promoting the modernisation and re-expansion of the industry. They would also be difficult to reconcile with our international policy, especially following the Venice Summit. There is too a danger that they would provoke the NUM into outright opposition to our coal strategy.

The Coal Board's EFL

9 One question that needs early decision is the size of the Board's EFL for 1981/82. We shall probably have to settle this before the EFL's of the nationalised industries generally since the miners' pay negotiations will begin in September. Following the general line of this paper, I propose that it should simply be the external finance figure for 1981-82 already settled for the strategy, revalued in a way to be agreed between my Department and the Treasury. We should also avoid imposing on the NCB the further requirement of achieving a specified target related to costs per unit of output. These two steps would not only recognize the paramount importance of the strategy but would help to preserve flexibility on miners' pay. We need not fear that the NCB would as a result be too ready to raise prices to cover increased costs. The fall in demand, and competition from imported coal, have faced them with a very difficult marketing situation. In particular, in the power station market, it is of vital importance to them that the CEGB should continue to conform to the understanding that they would take 75m tonnes of NCB coal a year if the real price did not rise. The NCB will do all they can to maintain this understanding.

Summary

10 I invite my colleagues to agree:

a We must persevere with the financial strategy agreed less than a year ago, even though it will not be easy to achieve and it will be some time before we can be sure of the outcome. We must ensure that the NCB take the hard decisions that will be necessary.

b Because the strategy is so important, we should not put it at risk by imposing additional requirements on the Board.

c The Board's investment programme should be approved in full.

d Their EFL for 1981-2 should be derived from the strategy figure for that year, revalued as agreed by my Department and the Treasury. We should not impose an additional target on them on unit cost of output.

Department of Energy
11th July 1980

D A R H

ANNEX

POSSIBLE NCB MEASURES TO KEEP ACTIVE THE FINANCIAL STRATEGY FOR COAL

1. In 1979/80 the NCB's external finance requirement was £673m, comfortably within their EFL of £709m; and their Accounts for the year, to be published at the end of July, will show that financial break-even was achieved after operating grants totalling £192m.

2. The NCB is now producing coal at above forecast levels and productivity is at high levels. However, market conditions are now more difficult and stocks are increasing rapidly. The NCB at present expect to be able to operate within the constraints of the strategy, but this will require difficult decisions.

3. The attached table shows separately the possible impact of various measures the Board could aim to take. Some of these could be combined, others are alternatives. It should be noted that in some cases the impact differs as between cash flow (which determines external finance requirements) and profit/loss (which determines the need for operating grants). Possible non-financial consequences of the measures are also summarized.

4. The NCB are fully committed to achievement of the strategy, and have discussed with the Department all the possibilities set out in the table. At the next monitoring meeting with the Board, which D/Energy and Treasury Ministers will hold at the end of July, the latest position on production and sales will be reviewed and NCB asked to indicate what action they expect to take, should it by then be clear that financial objectives will not otherwise be maintained.

CONFIDENTIAL

CONFIDENTIAL

MEASURE	IMPACT ON CASH FLOW (current prices)	IMPACT ON PROFIT/LOSS (current prices)	OTHER POSSIBLE CONSEQUENCES
Cut production at existing pits to prevent stock increasing	Reduces financing requirements for stock - could be £40 per tonne	Short-term benefit of avoiding stocking cost but also an increase in unit costs and reduction in productivity	International criticism (Venice); prejudicial to long-term targets.
Stock excess production	Substantial finance requirement (about £40/tonne)	Modest cost of stocking (£10/tonne) -assuming eventual sale	Increased security (but response of miners could be reduced production)
Sell excess product-ion at reduced prices in export markets or to back out imports	Operating losses need to be financed - up to £20/tonne. But by comparison with stocking benefits cash flow by around £20/tonne	Immediate impact at about £10/tonne	Presentation and industrial relations advantages - especially if imports reduced
More rapid pit closures	Each mtpa of closure benefits cash flow in every subsequent year by around £40m by comparison with stocking	Each mtpa of closures eliminates operating losses of say £5m average in every subsequent year (allowing for compensation.)	Strong union opposition; industrial unrest.
Increase prices	Immediate benefit. Danger of erosion through market loss.	Immediate benefit. Danger of erosion through market loss.	Increased costs to UK consumers; internal criticism; increased imports.

CONFIDENTIAL

CONFIDENTIAL

CONFIDENTIAL

MEASURE	IMPACT ON CASH FLOW (current prices)	IMPACT ON PROFIT/LOSS (current prices)	OTHER POSSIBLE CONSEQUENT
Reduction in inventories	Once and for all benefit of £20-30 million	Small	Some loss of goodwill in equipment industry leading to possible later difficulties
Cut investment	Most investment for next 2-3 years effectively committed.	Cuts would have little immediate impact but would be harmful in long term through reduced efficiency. And cuts which disrupted projects already in hand would have seriously damaging effect on long-term financial result.	NUM's cautious acquiescence in the financial strategy - because of its commitment to continuing investment in coal - might be changed to outright opposition.

CONFIDENTIAL