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PRIME MINISTER

Strategy for Coal

(E(79) 19 and a minute of 10 July from the Chief Secretary, Treasury, to the Secretary of State for Energy)

This paper from the Secretary of State for Energy follows a preliminary discussion of more detailed papers by him (E(EA)(79) 22 and Addendum) at E(EA) last Wednesday (E(EA)(79) 7th Meeting). The main thrust of Mr. Howell's detailed proposals was that:-

(a) Investment in the coal industry should be maintained.

(b) There should be an increased programme of closures for loss-making pits with improved redundancy, etc. payments to the workers concerned to make the closures more palatable to the National Union of Mineworkers.

(c) The industry's financial structure should be recast to reduce the burden of debt (by introducing PDC) and by eliminating its responsibility for historic deficiencies in its pensions arrangements (the industry carries as many pensioners as its currently employed workforce).

2. E(EA) did not discuss the proposals to reconstruct the NCB's finances which are for the Department of Energy and the Treasury to consider together in the first instance. Neither did they discuss the very wide difference of view between the Chief Secretary and the Secretary of State for Energy about the pace at which the NCB's deficit might be eliminated. They did however give a general blessing to the main thrust of Mr. Howell's strategy as far as investment and closures were concerned, while expressly reserving their position on the extent and nature of the steps to be taken to give effect to it.

3. The questions here are intimately bound up both with longer term energy policy and with the current public expenditure exercise. On the former there is no doubt that, even with an enhanced nuclear programme, we will continue to need a substantial coal industry for as far ahead as one can see if massive extra imports of coal and oil are to be avoided (the industry's current 120 million tonnes annual

output of coal is equivalent to 70 million tonnes of oil, which, if available and imported, would currently cost us £5 billion across the exchanges). On the other hand, although producing coal more cheaply than the coal industries of our EEC partners, the NCB currently loses a great deal of money £222 million in 1978-79 after interest and before grants) and requires upwards of £500 million of public finance each year for its investment capital. The Department of Energy's forecast is for losses and the capital requirement to continue at around present levels for the next few years. In the current public expenditure operation the Chief Secretary is looking to the NCB to save £55 million in 1980-81 with much larger sums in later years. Mr. Howell on the other hand is asking for more money than previously planned for 1980-81. (There is some uncertainty about how much extra he wants though the Chief Secretary puts it at £16 million) and assumes no very significant improvement in the following four years even with a substantial closure programme.

4. There are really six issues:-

(a) Should we continue to invest in coal at something like the present level? E(EA) could see merit in a high continuing investment programme both to provide a secure indigenous source of energy supply (without investment output would drop fairly rapidly) and as a means of reconciling the NUM to a faster closure programme for the unprofitable pits (the worst 10 million tonnes capacity loses £200 million a year). This view does not preclude asking the NCB to make do with a marginally smaller investment programme in the years ahead; or asking them to finance more of their programme from their own revenues; or allowing modest imports of foreign coal (we do not in any case have the physical infrastructure - ports and railways - to import more than say 10 million tonnes of coal a year at present).

(b) Should the closure of uneconomic pits be accelerated and if so is it worth paying more to "buy out" the opposition of the mineworkers concerned? Again, E(EA) thought the idea was sensible, though without committing themselves to specific measures. Given the £200 million annual loss from the marginal pits - and that these marginal pits are irrelevant to long-term coal supplies - the case for faster closures is strong, as is the case for higher redundancy payments if these ease the course of a major cost-cutting exercise.

(c) Should coal prices be further increased? There are inevitable delays in obtaining savings from pit closures - because of the quite elaborate consultative procedures built into the system and because of the costs associated with closure. Indeed, a closure programme of the kind Mr. Howell has in mind (3 million tonnes of capacity a year) would involve higher costs in 1980-81 (of the order of £10 million) in order to achieve savings in subsequent years. But if savings from closure come through slowly the industry's finances can only be brought to order by one or more of the following measures:-

(i) Reduce investment at the margin (the Chief Secretary would argue that the £55 million he seeks in 1980-81 is at the margin on a programme exceeding £500 million).

(ii) Increase productivity. The trouble here is that significant productivity improvements are already assumed in the figuring and, given the shape of the industry's productivity scheme, much of the financial gain from improvement goes to the men. The papers do not discuss how, if at all, productivity could be increased. The point is worth pursuing though Mr. Howell's caution reflects past experience.

(iii) Raise prices. E(EA) did not discuss the scope and merit of further increasing coal prices and, although the point was made at the public expenditure discussions following Thursday's Cabinet, the Secretary of State for Energy gave no clear answer. However the industry's turnover is around £3 billion a year so that each 1 per cent increase in prices across the board brings in £30 million. And OPEC raised the price of oil again substantially only a few weeks ago and may well do so again before we reach 1980-81. If money is to be found other than by cutting the investment programme there is where it must come from. Mr. Howell needs to be pressed.

(d) Should the Government get heavily involved in questions such as closure and redundancy pay or should it set the financial parameters and leave the NCB to get on with its job? This question is bound up to some extent with general policy towards the nationalised industries some aspects of which are to be discussed at this meeting under item 2 of the agenda. But the broad principle of the Government's policy is clearly to stand back as far as circumstances permit from the affairs of the nationalised industries. And to get involved in urging one level or another of closure on the NCB is for the Government to put itself directly in the firing line with the NUM. There is thus much to be said for fixing the limits of financial help and leaving the NCB management to do the job it is paid for (assuming the NCB is capable of acting without having its hand held by Government - you could ask Mr. Howell for his assessment of the Board's performance and attitude). On this reading the key next step is to set the financial limits for 1980-81 - and this in turn means taking a view on the dispute between the Chief Secretary and the Secretary of State for Energy on what those limits should be. On the face of it, given that the difference between them for 1980-81 is only some £70 million, representing a little over 2 per cent on prices - if indeed prices need to carry the whole burden of adjustment - and given the need for public expenditure savings, your colleagues may feel that the verdict should go in favour of the Chief Secretary. Financial limits for later years do not have to be set now but can wait until public expenditure in 1981-82 and later years is discussed by Cabinet in the autumn. The key issue then will be how far and how quickly it is possible to seek to reduce the NCB's deficits. Any broad guidance which might emerge from E would be useful.

(e) Is there some radical recasting of the organisation or direction of the NCB which would serve better than the present set-up? A number of ideas surfaced briefly at the E(EA) discussion, e.g. turning the coal mining industry into some kind of co-operative venture. You may feel that these ideas have little immediate relevance: they would certainly require a good deal more thought before their feasibility could be determined. If anyone presses them they could be remitted for study.

(f) Recasting the NCB's capital structure. This possibility, mooted by Mr. Howell, is, at bottom, an arrangement for converting overt subsidies to the NCB into covert ones (it has happened several times before). If action is to be contemplated a very strong case will need to be made out. The Secretary of State for Energy and the Chancellor of the Exchequer might be asked to study the issues together and come up with a joint analysis.

CONCLUSIONS

5. Subject to discussion you might guide the Committee:-

(i) To endorse the broad lines of E(79) 19 subject to the points made in discussion.

(ii) To decide that the finance to be made available to the NCB in 1980-81 should be reduced as recommended to the Cabinet by the Chief Secretary, Treasury and to confirm that responsibility for keeping within those limits, by whatever means, rests with the NCB.

(iii) To note that financial limits for the NCB in the three years following 1980-81 will need to be settled in the autumn. The Chief Secretary, Treasury, should be invited to discuss these matters further with the Secretary of State for Energy with a view to reaching agreed proposals in the light of the Committee's discussion.

(iv) To remit the question of a capital restructuring of the NCB for joint study by the Secretary of State for Energy and the Chancellor of the Exchequer with a view to the production of an agreed analysis by the end of the Summer Recess.

(John Hunt)

16th July, 1979