Prime Minister
I have warned Energy that you will want to question Mr Howell on this.

What incl
Costs? - overheads?
- Hobart House
- very well cleaned we settled
- effect on high energy industries.
- effect on elec. prices
- absenteeism.

Ref: A02994

Tim - What I don't find in these figures is any attempt to cut the costs of production. That is what private industry would have to do.

PRIME MINISTER

Strategy for Coal
(E(80) 96 and 99)

Background

In E(80) 96 the Secretary of State for Energy gives estimates of the external finance requirements of the National Coal Board from 1981-82 to 1983-84 and of the corrective action necessary to bring them back on course.

2. The key figures are usefully tabulated in Annex C1. They are at estimated outturn prices and not 1980 Survey prices and so are not readily comparable with the PEs figures used in other contexts. The inflation assumptions underlying them are not stated. Line 2 shows further external finance required because of lower demand, and lines 4 (i)-(v) provides some senitivity analysis on varying assumptions about labour and other operating costs. Lines 3 (i)-(iv) show the effect of the corrective measures already in hand - principally stepping up closures, and pricing to enable import substitution and increased exports. But these measures still leave net requirements in excess (in line 4) of the present ceilings.

£ million	1981-82	1982-83	1983-84
Assumed outturn prices	123	280	522
which might translate roughly into 1980 survey prices as:	95	196	332

3. This excess clearly represents a major threat to the Government's public expenditure plans. The Secretary of State for Energy proposes to invite the NCB to put forward proposals to eliminate it by a combination of reduction in output at continuing pits and reduction in capital investment. He does not say

when he would report back but it would have to be in mid-October for the outcome to be taken into account in the final public expenditure discussions at the end of that month. In the meantime the Committee cannot reach final decisions but it can give the Secretary of State guidance on points which should be taken into account in the further work.

4. In E(80) 99 the CPRS argue that in view of the evident substantial over-capacity the Board should be asked how an increased closure programme could be achieved, what would be the risks of confrontation and how these might be minimised. They underline the point that action to reduce cash requirements over the period will inevitably have a short-term adverse effect on revenue account - because of redundancy payments and other costs associated with accelerated closures. They suggest that these might be treated as extraordinary items, below the line.

Handling

5. After the Secretary of State for Energy has introduced his paper the Chancellor of the Exchequer will wish to comment. He will probably wish to draw attention to the paper E(80) 104 - due to be circulated before the meeting - assessing the overall impact of the nationalised industries on public expenditure plans and the need to achieve substantial reduction in their requirements. This paper has been circulated primarily as background to the discussion of steel, shipbuilding and rail on Wednesday, but it is equally relevant to coal. The Secretaries of State for Wales and for Employment and Lord Mansfield will also wish to speak.

included here

6. In discussion you will wish to cover the following -

i. Closure costs. The Board have already stepped up the rate of closures from the equivalent of $1\frac{1}{2}$ million to $2\frac{1}{2}$ million tonnes a year. It seems reasonable that in the further work to eliminate the excess they should consider, as proposed by the CPRS, how an increased programme could be achieved and what would be the consequences. It might well be worth paying the price of more attractive redundancy payments to achieve the longer term benefits. Ministers will no doubt want some indication of where these closures would be likely to take place.

ii. Investment. The Board will be pursuing the possibility of further cuts. They are likely to argue that investment in new productive capacity is essential to their longer-term strategy. On the other hand their investment plans cannot be immune to the present fall in demand and the consequent over-capacity. The case for new investment would be much stronger if it was in parallel with increased closures of high costs, inefficient pits.

iii. Prices. The working assumption appears to be that since prices are largely market determined, and it is undesirable to push up electricity costs, the Board cannot price themselves out of trouble. This assumption would bear probing because, although the Board set great store by their agreement with the CEGB, the latter will remain largely a captive customer throughout the period. At least the Government ought to have the option of higher prices as an alternative to a higher PSBR.

iv. Pay. The sensitivity analysis in Part 4 of Annex C1 gives some indication of the consequences of increases in labour costs. But the Committee will want the Secretary of State to comment on what might be the implications of possible outcomes of the miners' pay settlement this year. There must be a risk of painful decisions now to eliminate the excess with the excess then re-emerging following the settlement.

v. Implications for revenue account. The Committee are likely to endorse the view that priority must be given to reducing the cash requirements of the Board, even though in the short-term this might have an adverse effect on revenue account.

Conclusions

7. In the light of discussion you will wish to record conclusions -

1. Noting the present position as reported by the Secretary of State for Energy.

2. Inviting him to circulate a further paper in time for discussion in the week beginning 13 October with proposals, or options, for eliminating the excess now identified and taking account of points made in discussion.

D J Wright

ROBERT ARMSTRONG

(approved by Sir R. Armstrong and signed on his behalf)

12 September 1980