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Andrew Turnbull Esq  
Private Secretary to  
The Prime Minister  
10 Downing Street  
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29 May 1984

*Dear Andrew,*

COAL DISPUTE: FINANCIAL IMPLICATIONS AND THE  
REBUILDING OF STOCKS

I attach a copy of the paper my Secretary of State  
has prepared for his meeting with the Prime  
Minister and the Chancellor at 4.30 pm this  
Thursday.

I am copying this letter and paper to David Peretz  
in the Chancellor's office. Mr Walker has asked  
that the paper should only be seen by those who  
strictly need to know about its contents.

*Yours*

*John*

J S NEILSON  
Private Secretary

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P.M.  
Chancellor  
Energy Sec.

cc Mr Gregson C.O.

29 May 1984

COAL DISPUTE AFTERMATH:  
FINANCIAL IMPLICATIONS AND THE REBUILDING OF STOCKS

1. The financial effects of the coal dispute and the nature and cost of the problem of stock rebuild will depend on how long the strike continues and how fast we decide to rebuild the stocks. But they could also be much affected by the terms on which the strike ends. If management's hands were tied by the settlement, that could affect the freedom to rebuild stocks, further postpone NCB viability, increase future subsidies and have pervasive cost effects in the economy e.g. on public sector pay. The contrary is also true. It is not possible to measure any of this with confidence until the outcome is clear. It was agreed at the Prime Minister's meeting on 15 May that no final view could be taken on financial aspects or on stock rebuild until the circumstances of the end of the strike were known.

2. However, this note tries to suggest some orders of magnitude. The first part of it is about costs during the strike. The note begins by identifying the main factors affecting the PSBR. It then describes, with due reservation, two scenarios for the duration of the strike and puts a rough PSBR price on each of them; and tries to estimate the effects of each scenario on the external financing position of the NCB and the CEGB. The second part of the paper deals first with the physical and then with the financial problems of stock rebuild under the two scenarios.

Finally, there is a section on the recovery of net CEGB costs from electricity consumers .

The Strike Period: Nature and Scale of PSBR Effects

3. Estimating these effects means ignoring all intra-public sector transactions, "consolidating" the coal and electricity industries and looking solely at transactions with the private sector. The main effects are:-

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- (i) NCB wage savings, less losses of sales revenue from the private sector. Loss of NCB sales revenue from the CEGB is within the public sector. The net effect at present, with a quarter of the industry still working, is a saving of about £25/30m a week. The electricity industry is able to maintain receipts from electricity sales to the private sector at the same time as the NCB makes these wage savings by drawing on coal stocks.
  
- (ii) cost of CEGB oilburn, gross: about £50m a week. The offsetting savings on coal purchases from the NCB are within the public sector.

There are also some smaller and even less quantifiable effects:-

- (iii) costs of additional policing and social security benefits. Perhaps £3/5m a week.
  
- (iv) possible effects on NCB investment. For a strike ending on 1 July, the NCB are now saying their 1984/5 capital expenditure would be £730m instead of £800m. But there may be catching up or additional costs in either 1984/5 or 1985/6.

4. The net cost to the PSBR of these factors can be put very roughly at £25m a week while stocks last. But there are many indirect effects. For example CEGB and industrial oil purchases have certainly firmed the crude oil price. A plausible estimate puts this effect at 30 cents a barrel, equivalent, allowing for term sales, to 15 cents a barrel on all North Sea oil sales and thus worth about £5m a month in tax to the Exchequer. The strike has weakened the exchange rate, with a variety of effects including an

..increase

increase in sterling proceeds of North Sea oil taxation. There is some loss of tax revenue because of the loss of output. Many of these effects are likely to be temporary. On the other hand the benefits to the PSBR and the economy from an outcome to the dispute which enabled the NCB to eliminate high cost output would be likely to be large and permanent.

Aggregate PSBR costs of two strike scenarios

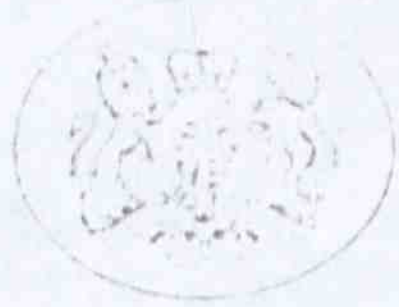
5. Two scenarios useful as illustrations are (A) that the strike ends on 1 July after 16 weeks or (B) on 1 October after 29 weeks. That would mean 13 and 26 weeks respectively in the financial year 1984/5. In both cases it is assumed that a quarter of the industry continues to work, with corresponding coal movements. Better and worse scenarios can readily be imagined. The 1984/5 PSBR costs up to 1 July and 1 October would be roughly £325m and £650m.

NCB and CEGB finances

6. The cash positions of the NCB and the electricity industry are affected by the payments between them as well as by their position in relation to the private sector. The NCB is saving on transactions with the private sector but losing large payments from the CEGB. Because of the oilburn the electricity industry loses in relation to the private sector but gains in relation to the NCB. Roughly the NCB has a net cash loss of £35m a week because of the strike and CEGB has a net gain of £10m a week. So the impact on their 1984/5 financing requirements up to 1 July and 1 October would be :-

Scenario A: NCB £455m deterioration : CEGB £130m improvement  
(Net £325m)

Scenario B: NCB £910 deterioration : CEGB £260m improvement  
(Net £650m)



7. These "guesstimates" are for the effects of the strike. They do not cover changes from other causes in the finances of the two industries, compared with the published public expenditure figures for 1984/5.

8. The NCB deficit grant is by statute related to the NCB's accounts and not to its cash position as discussed in paragraph 6. The scale of grant for 1984/5 and the timing of any amendment to what has been forecast could be presentationally important, but is not in itself of critical importance for the Government's finances. Its effect is to determine how much of the NCB's cash outflow is met by grant and how much by NLF borrowing. The pre-strike deficit grant estimate was £522m. This is bound to increase but by how much depends on the length of the strike and the nature and timing of the stock rebuild.

#### Stock Rebuild

9. At 1 November 1983 coal stocks were 31m tons. The minimum level at the beginning of the winter thought necessary to maintain supplies without oilburn, if need be in very cold weather, would be roughly 15m tons.

10. Rebuilding very quickly to a level well above 15m tons, and equivalent as nearly as possible to 6 months endurance, would be expensive, mainly because of the scale of oilburn it would require. There would be a judgement to be made about the risk of further industrial action during the winter, on top of a long and exhausting overtime ban and strike; and on the premium to be paid to guard against that risk. And broadly, the greater the risk, the more the Government is likely to be inhibited in guarding against it. If the strike were to end with the NUM in a strong position, importing, oilburn and rapid stock-build might all be inhibited. If their position were weak, rebuild would be easy but less necessary.



11. The level of coal stocks at 1 July and 1 October under scenarios (A) and (B) would be about 15m and 10m tons respectively. Pithead (including opencast) stocks, on the same assumptions, might be 24m and 26m tons.

12. If there were no serious inhibitions of the kind discussed in paragraph 10 and the Government decided to rebuild stocks as rapidly as possible towards six months endurance (equivalent to 30 million tons at the seasonal peak of 1 November, but rather less in later months), the main limitation would be transport, especially the capacity of the rail system. In the 1982 accelerated delivery programme, weekly deliveries averaging 1.85m to power stations were achieved by rail and road. It might be possible to improve somewhat on this but it seems wise to regard 1.95m tons as near the maximum. The first charge on these deliveries would of course be normal power station consumption: between 1.5 and 1.9m tons a week in October to March.

13. Imports might make some, but only a limited, contribution. They would have to be fitted into the supply and transport pattern so as not to displace any part of the 1.85/1.95m tons a week above. Extra deliveries to Thames-side power stations would tend to back out sea-borne NCB coal from Durham which could not readily be routed elsewhere. For inland power stations transport would be a problem. A doubling of the normal import rate would bring the import contribution to 60,000 tons a week.

14. For the earliest possible return to 6 months endurance a major contribution would have to come from continued oilburn, worth at a maximum 0.5 to 0.6m tons of coal a week.

15. The results of a combination of these methods for the level of coal stocks at 1 November 1984 might be:-

|                    |          |
|--------------------|----------|
| <u>Scenario A:</u> | 26m tons |
| <u>Scenario B:</u> | 15m tons |

The dates for reaching a stock level equivalent to 6 months

.. endurance

endurance would, on these assumptions, be November/December under Scenario (A) and February/March under (B). Oilburn would be required until those dates.

#### Finances of Stock Rebuild

16. The cost of stock rebuild would be minimised by maximum transfer of existing pithead/opencast stocks to the power stations. This method is as near PSBR neutral as may be: there are large payments to the NCB and British Rail but little to the private sector.

17. Stock rebuild ought however not to interfere with the objective of reducing marginal, high-cost NCB output so as to achieve a balance of supply with normal, economic demand at lower average output cost. Closures should not be held up for stock rebuild.

18. But overwhelmingly the main PSBR consequence of a very rapid rebuild would be the cost of oilburn at about £50m a week; with a much smaller addition for eg extra wage costs in NCB, British Rail or elsewhere attributable to the need to move or produce extra coal for stock. Under both Scenarios fastest stockbuild involves 20/25 weeks of oilburn. The £50m a week cost would taper off somewhat as coal stocks reach their maximum at certain stations, but the PSBR charge in 1984/5 could under either Scenario be £ $\frac{3}{4}$  billion or more.

19. Oilburn apart, the effects of the rebuild on NCB and CEGB finances will depend critically on how much coal can be moved between them between the end of the strike and the end of the financial year. The figures above for rebuild and oilburn imply NCB coal movement for power station stock of about 3 or 6m tonnes in Scenario (A) or (B).

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There might be up to a further 1 million tons of extra sales by NCB to rebuild stocks in industry. The impact of the rebuild period on NCB and CEGB financing requirements in 1984/5 would on all these assumptions then be very roughly:-

Scenario A: NCB £150m improvement : CEGB £800m deterioration

Scenario B: NCB £300m improvement : CEGB £1000m deterioration.

20. These figures are very sketchy indeed and would require much reworking with the industries, but they bring out the point that for the PSBR the speed of rebuild of stocks and the extent of oil use are critical. It seems essential to get these costs down by avoiding or reducing post-strike oilburn. This might mean accepting a slower rebuild. It should certainly mean reviewing once again every possible means of moving pithead coal stocks.

21. If the strike period and rebuild period figures in paragraphs 5 and 18 are added, they suggest a total PSBR cost of £1bn for Scenario A and £1.4bn for Scenario B, if stocks had to be fully restored before 31 March 1985. In practice it is very likely under Scenario B that some costs would fall into 1985/6. Slower rebuild would of course spread more costs into 1985/6.

#### Electricity Consumers and Strike Costs

22. It was agreed at the Prime Minister's meeting on 15 May that it would be better to avoid any electricity price increase during the dispute. The figures in paragraph 6 tend to reinforce that conclusion since they show the cash position of the electricity supply industry as actually improved during the course of the strike, in spite of the oilburn.

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23. The dramatic deterioration in the finances of the electricity industry would arise in the stock rebuild period, mainly if there were then prolonged oilburn. The question would be how far consumers could be asked to pay for a decision to rebuild stocks more rather than less rapidly through oilburn. This would not be a straightforward commercial deterioration in the CEGB's accounts, or a deterioration incurred in rebuilding stocks to commercial levels. Consumer Councils could be expected to take this point.

But is being done with the long term interests of consumers in mind

24. The earliest dates from which any price increase could be expected to operate if a proposal to make it were made soon after the end of the strike would, allowing for the usual consultative processes, be about 1 September 1984 for Scenario (A) and 1 January 1985 for Scenario (B). But it seems difficult usefully to carry this question any further until the circumstances of the end of the strike and the character of the stock rebuild are known. As a ready reckoner, a 1% price increase for both industrial and commercial consumers raises £100m in a full year .

#### Summary

- (i) the PSBR cost of the strike is running at very roughly £25m a week; in effect, the oilburn cost less the wage saving;
- (ii) the fastest possible stock rebuild after the strike would require oilburn for upwards of 20 weeks at up to £50m a week; a PSBR charge of something over £<sup>3</sup>/<sub>4</sub> billion.
- (iii) there is a strong case for looking again at every possibility for moving pithead and opencast coal to power stations as soon as the strike ends.