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PRIME MINISTER

STRATEGY FOR THE COAL INDUSTRY

Over the coming months we will be facing a number of decisions relating to the NCB and other coal issues. The immediate focus will be the NCB's corporate planning material due this month and this Autumn's public expenditure discussions (where the NCB has additional bids of over £1 billion). Looking further ahead, we have to plan the content of the Bill which will need to be introduced in Autumn 1986 to provide the legislative framework for the NCB beyond March 1987 (when the present legislation expires).

2. These decisions need to form part of a coherent strategy for the coal industry. I attach a note which seeks to outline such a strategy.

3. Our stance in the coal strike won widespread support. People readily saw the sense in standing firm, at considerable cost, in the face of unreasonable demands pursued by means of violence and intimidation. It is now of prime political and economic importance to demonstrate that we make use of our hard-won success in the strike to put the coal industry on to a sensible footing and stop the drain on the taxpayer.



4. I am, however, concerned that full use may not be made of the opportunity we now have. The position may be clearer later this month when we see the NCB's plans. Clearly a rapid rundown of uneconomic capacity is of prime importance.

5. Beyond this the NCB needs to make a proper return on the assets employed in its deep mined activities. At the moment the full extent of the losses here are disguised by the profits - running at around £200 million a year - on opencast. Opencast needs to be hived off into an organisation wholly separate from the NCB and then privatised.

6. Privatisation of deep mines does not seem a realistic possibility during this Parliament but we should take steps which would make it a real prospect in the next Parliament. These steps are set out in the attached note.

7. Prior to privatisation we need to transform the NCB from cosy collectivist organisation used to living on a diet of large subsidies to a commercial body whose size is determined by its success in the market place, unaided by subsidies.

8. I am sending this to you on a personal basis, and would be happy to discuss it with you should you so wish.

A handwritten signature in black ink, appearing to be 'NL'.

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2 September 1985

**STRATEGY FOR THE COAL INDUSTRY**

This note describes the strategy which the Government might adopt towards the UK coal industry. The issue will come before colleagues in the next month or so when the National Coal Board (NCB) produces its outline corporate plan.

A. Objectives for the coal industry

2. The short term and longer term aspects are best considered separately.

(i) Short term

3. The key points in the objectives set for Mr MacGregor are:

- (a) the NCB should earn a satisfactory return on capital;
- (b) the Board should secure sales which are profitable on a continuing basis and should bring its capacity into line with these sales;
- (c) real costs should be reduced.

Mr MacGregor also agreed that the NCB should break even by 1987-88 after taking credit for so-called social grants which the Government would continue to pay towards the costs of mine closures and redundancies.

4. The key to achieving these objectives is the closure of uneconomic pits. It is essential that the NCB exploit to the full the opportunity they now have as a result of the successful outcome of the coal strike. Before the coal strike the NCB anticipated these objectives would require the closure of 21 million tonnes (mt) of capacity by 1987-88.

5. Break even by 1987-88 remains a challenging objective and longer term aims may have to take a lower priority. Even so break even should only be seen as an interim target for the following reasons:

- (a) after stripping out continuing Government grants, break even will in fact still represent a real loss - equivalent to over 1 per cent of capital employed;
- (b) profitable open cast activities will still be subsidising loss making deep mines by about £200 million a year;
- (c) profitable deep mines will also be subsidising loss making deep mines by perhaps another £200 million a year.

In short, at what on the surface appears to be break even, the NCB will still be far from commercial viability.

(ii) Longer term

6. Coal is not a natural monopoly. In principle, the industry should consist of a number of private sector companies selling such coal as they can profitably produce in competition with each other and with coal producers in other countries. The size of such an industry would be set by:

- (a) the selling price set for coal in the existing international market;
- (b) investors' assessment of whether individual mines (or prospects) offered a sufficiently attractive return after taking account of the risks.

7. In practice there are a number of obstacles to the development of the industry in this way:

- (a) all mineral rights are vested by statute in the NCB and the NCB has a statutory monopoly over coal extraction. This gives the NCB significant control over such non-NCB operations as do exist;
- (b) the NCB owns 97 per cent of coal extraction capacity;
- (c) the CEGB has agreed to meet 95 per cent of its coal requirements from the NCB until 1987. This effectively limits competition from imports over the next two years.

#### B. The Way Forward

8. The essence of policy towards the coal industry should be that the size of this industry, like any other, must be determined by the amount of output it can sell profitably in the market place. Previous Governments have seen the size of the industry as determined by what it could produce, regardless of whether this could be sold profitably.

9. The most direct way of ensuring the coal industry is market determined in this way would be privatisation, coupled with a break up of the NCB and with removal of the obstacles described in paragraph 7 above. There must, however, be doubts about whether the bulk of the NCB's existing assets would be attractive to private sector investors. And privatisation of profitable new mining projects alone could give the NUM a grievance to exploit, which does not apply when closures of old capacity and new investment elsewhere in the business can be presented as a reasonable package.

10. In these circumstances the right approach is one which:

- (a) seeks to obtain as many as possible of the benefits of privatisation;

- (b) aims to reshape the NCB in such a way as to make privatisation a real prospect during the next Parliament.

11. The main features of such an approach would be:

- (i) to deal with the unsatisfactory nature of the NCB's finances in the short term (para 5 above)

(a) rapid closure of all uneconomic pits. This is of paramount importance.

(b) ensuring the NCB invests only in existing pits, and new developments, which offered a return of at least 5 per cent after risk;

(c) a major reduction in the NCB investment programme to ensure that, apart from essential safety measures, investment was confined to profitable activities;

(d) ending of continuing Government grants;

(e) separating of open cast activities into an organisation separate from the NCB which would operate in competition with the NCB. This organisation would be a prime candidate for privatisation in 1987-88.

- (ii) to overcome the obstacles to greater market exposure of the coal industry (paras 6 and 7 above)

(a) removing the mineral rights from the NCB and ending its monopoly in extraction. New operators to be licenced by the Department of Energy;

(b) continuing the policy of selling NCB coal at prices set by competing imported coal;

(c) ensuring there are no further restrictions on the CEGB's ability to import coal. The existing CEGB-NCB agreement should not be renewed in 1987.

12. As regards the structure of the NCB it would be right to retain a national organisation.

(i) The upheaval of break up would probably not be matched by the benefits;

(ii) a national dimension is needed to ensure that the appropriate level of investment is made in pits in Nottinghamshire and elsewhere in the Midlands where there is less union militancy than in other areas.

That said, it would be reasonable to allow work/management buy out for pits which would otherwise be closed.

13. Within this national structure, it would make sense to publish the NCB's accounts with a regional breakdown and to align the NCB regions with the NUM's areas. This would:

(i) help to create a greater regional sense of identity for mineworkers and so to offset the NUM drive for centralisation of power within the union;

(ii) make it possible to increase the productivity related element in the miner's pay package.