Prime Minister
You have in mind a meeting with the Chancellor and Mr Walker for 1-2 months time.
DRN 6/3.

PRIME MINISTER

6 March 1987

Yes — but a preliminary talk would be a good thing - otherwise too little will be done now.

ENERGY COMMITTEE REPORT ON THE COAL INDUSTRY

Last week the Commons Energy Committee published its report on the coal industry. Shortly after, Sir Robert Haslam addressed the Coal Industry Society on the "Way ahead for British Coal".

Both sources comprehensively chart the industry's impressive recovery since the 1984/85 strike:

- overall labour productivity increased by a quarter over the year following the strike;
- unit operating costs this year are expected to be 20% lower in real terms than those before the dispute;
- since the strike 60 uneconomic pits have been closed or amalgamated;
- some 60,000 mineworkers and 78,000 staff in all have left BC since the end of the strike - the average age of BC's mineworkers falling to 34.

This looks encouraging and the Energy Committee is all for letting the recovery continue with the minimum of disruption. However, some of the old rocks remain. The unions are still tenaciously defending outdated work practices on spurious grounds of miners' safety and welfare. Half the recent 25% increase of productivity derived from greater use of highly-mechanised face equipment. Yet due to the constraints of the 1908 Powers of Work Act and the 40-year-old Five-day Week Agreement, costly capital equipment is only being used for a third of the available time. This would be unthinkable in comparable capital intensive industries, including deep US coal mines.

So far BC has made no progress in devolving the negotiation of wages and conditions to area or coal field level, with the aim of giving miners appreciably higher rewards for adopting work practices tailored to the highly-mechanised equipment at their disposal. Regrettably the short-sighted, defensive leadership of the UDM is showing no more inclination than the NUM to respond to BC's encouragement in this direction. The need for modern work practices to realise the full benefit of today's mining techniques is central to the questions of how and when the coal industry should be restructured and privatised.

The Conservative majority on the Energy Committee advocates a step-by-step approach; first, correct a basic flaw in the industry's structure by vesting the ownership of coal in the Crown and transferring to the Department of Energy the licensing of coal, the regulation of the industry and the collection of royalties - i.e. the same regime as for oil and gas production; then use these powers to liberate and expand the small private sector component of the industry which currently accounts for only 2% of UK coal production; leave BC in the public sector at least until the trend of rising productivity returns the business to profit.

The snag is that BC's productivity improvements still have a long way to go before the business is commercially sound. Bob Haslam reckons that BC must aim for a target of 5 tonnes/man shift for average labour productivity, compared with the present much-improved 3.5 tonnes. Unit operating costs need to be reduced by another 20% in real terms. Further improvements on this scale cannot be achieved without the introduction of modern work practices tailored to local circumstances. But this essential reform may well prove impossible with the industry as currently constituted; the forces of reaction are too deeply entrenched. Here lies the case for a bolder and more rapid process of restructuring and privatisation to force the requisite changes.

A Conservative Government beginning its Third Term with a good working majority will have to choose between:

(a) postponing reform of the coal industry in the hope that BC can first be returned to profitability (Haslam);

(b) laying the foundations by separating BC the business from BC the licensing authority, regulator and tax collector, whilst liberalising the small private sector industry to act as a competitive spur to BC (Energy Committee);

(c) as well as doing (b), breaking up BC by privatising the profitable opencast mines and encouraging management/workforce buyouts, perhaps in joint ventures with private sector mining or energy companies (Redwood).

The Pros and Cons

Option (a) misses the window for bold early action. If the Government postpones reform we could easily end up approaching the following election with BC stuck in third gear and unable to sustain the productivity increases needed to return to profitability.

Option (c) entails early bold action but may not ultimately lead to the best result. Privatising the opencast mines will be easy, but they are already privately operated under competitively-tendered contracts. The real target for reform is BC's deep mines which account for at least 85% of BC's total production. If only the UDM was showing more enlightened vision and could be relied upon to respond positively to the opportunity of management/workforce buyouts.

Option (b) is fine as an initial step, but the Government will probably need two terms to achieve its ultimate goal.

We must not overlook the closely-related privatisation of electricity. The privatisations of BC and the ESI need to be planned and executed as a carefully co-ordinated programme. In the end this more than anything may determine the Government's preference for a step-by-step approach to coal privatisation (b) or the fast-track approach (c).

Conclusion

In the case of coal and electricity privatisation we are playing with high political stakes for a big economic prize. For such a task, even a full Parliamentary term may not be sufficient; particularly if the Government embarks on a Third Term with no more than hazy concepts and bold rhetoric. We need to start developing a carefully-planned and realistic blueprint so that the new Secretary of State can, as it were, "hit the deck running".

JW.

JOHN WYBREW