

P 03731

PRIME MINISTER

at flag FUTURE STRATEGY FOR BRITISH COAL *flag A.*

[Mr Wakeham's minute to you of 13 July; *flag B.* Mr Potter's reply of 27 July; Mr Major's letter to you of 30 July; Mr Carrington's letter to Mr Potter of 20 September with an annotated agenda for the meeting.] *flag C.*

DECISIONS

1. Mr Wakeham has reviewed the Corporation's strategy over the next few years. Although no final decisions are required now, he wants to give the Corporation guidance on the approach to adopt to the issues which it will face. You will want to decide whether you are content with his approach.

2. The main points are:

a. British Coal's future strategy ought to be based on a return to profitability, not maintaining production levels. You may wish to endorse this fundamental premise.

b. The implications of this for future production depend on negotiations with the Generators (National Power and PowerGen) for coal contracts beyond the end of March 1993. But a substantial reduction is almost certain to be needed, and you will wish to be satisfied that the implications of substantially lower domestic production capacity are acceptable.

c. British Coal should not try to anticipate the significant closures which will become necessary in 1993 (although it could take advantage of any opportunistic closures which might arise between now and then) because this would prejudge the outcome of negotiations with the Generators. You will need to decide whether you are content

for British Coal to wait until 1993 before carrying out further major closures.

d. British Coal should plan to achieve manpower reductions by voluntary redundancy only, with referral of closures to the Independent Review Body (IRB). But British Coal are not confident that they can achieve the necessary closures by that means, and they may seek more generous Government restructuring grant. You may wish to conclude that the present policy should be maintained, but will need to be reviewed once the likely scale of closures is clearer.

3. Mr Wakeham says that these proposals should not close off any options on privatisation in the immediate future, and suggests deferring discussion of privatisation until he has discussed the options with his officials. You may want to ask when he is likely to be ready for such a discussion.

4. If you accept Mr Wakeham's approach you might want him to circulate a draft setting out the terms in which he will convey the decisions to British Coal.

BACKGROUND

5. Mr Wakeham minuted you on 13 July on the outcome of his review of British Coal's future strategy, which followed the conclusion of negotiations on the present 3-year coal contracts with the Generators. Your office (Mr Potter's letter of 27 July) proposed a meeting to discuss the issues. The Chancellor wrote on 30 July expressing broad support for the strategy. Mr Wakeham's office wrote to Mr Potter on 20 September with an annotated agenda for the meeting.

MAIN ISSUES

Implications of reducing capacity

6. Both the Chancellor and Mr Wakeham favour a market-driven approach, which would oblige British Coal to aim at returning to profitability. This is expected to mean a reduction of around a third of British Coal's existing capacity (paragraph 7 of Mr

Wakeham's original paper). The implications would presumably include increased dependence on other fuels and/or alternative sources of coal supply. You may wish to consider the following points.

a. World oil market instability. Recent events in the Gulf have highlighted the vulnerability of the oil market to political developments in the Middle East. You might ask whether Mr Wakeham regards this as a significant consideration.

b. International coal supply. Mr Wakeham is presumably satisfied that the longer-term world supply position for coal, including special coals, is such that the availability and prices of foreign coal are unlikely to change enough to call his proposed strategy into question. You may wish to check that his assumptions are robust.

c. Industrial relations. As British Coal loses its dominant role as supplier of fuel for electricity generation the industrial relations risks will also diminish. But you might wish to ask whether the likely reduction in capacity will tend to bear disproportionately on the more moderate areas and pits.

7. If you are satisfied that the implications are acceptable, you will no doubt wish to endorse Mr Wakeham's approach, and in particular the importance of future coal capacity being determined on the basis of profitability rather than volume targets.

Timing of capacity reductions

8. Mr Wakeham does not envisage taking further action to reduce capacity before 1993. His approach would be to allow the Corporation to continue production at levels sufficient to meet the full volumes provided for in existing contracts with the Generators, and leave further capacity reductions until 1993. However he would not rule out opportunistic closures.

9. Starting the programme of closures now would tend to reduce the scale of the problem to be faced after 1993. Mr Wakeham believes that British Coal's credibility with the Generators for negotiating future contracts will depend on their meeting the contractual volumes in full. But in practice the Generators may not set much store by full contractual performance (the contractual volumes were accepted only with some Government pressure) if alternative supplies are readily available.

10. On the other hand British Coal already have a major closure programme in hand, and adding to this would not necessarily be easier than a further round of closures in 1993. Their own preference would be to wait for the outcome of the negotiations with the Generators, which should provide a firm basis for further adjustments in capacity.

11. You will want to consider whether to endorse the strategy of waiting until 1993 before pursuing further capacity reductions.

Voluntary redundancies and the IRB

12. Mr Wakeham wishes to maintain the current policy of relying on voluntary redundancies, and of allowing referrals of colliery closures to the (advisory) Independent Review Body. British Coal believe that it could be difficult to carry through the closure programme on this basis. You will wish to consider the arguments:

a. British Coal may be tempted to press for an increase in the level of restructuring grant. But this already amounts to 90% of the costs British Coal incur in persuading miners to leave the industry.

b. Resistance supported by the IRB would be more effective in the case of closures on economic grounds of pits which are not yet exhausted, but it would presumably only delay rather than prevent closures.

c. Relying on voluntary redundancies may delay the speed at which the industry can be restructured, and might lead to overproduction for a transitional phase if the electricity industry looks elsewhere for supplies.

d. A continuation of the current policy on voluntary redundancies and IRB hearings may on the other hand be the best safeguard against industrial relations problems while the closure programme is implemented.

You may wish to conclude that the current policy of relying on voluntary redundancies and referring closures to the IRB should continue, but should be reviewed once the planned level of closures is known.

Expansion overseas

13. Mr Wakeham suggests that the Government ought to be prepared to look at any proposals from the Corporation for expansion overseas. He believes that this would help to maintain management morale, although he rehearses the possible objections in his annotated agenda:

- a. the lack of justification for significant extra exposure;
- b. possible industrial relations difficulties;
- c. policy arguments against expanding nationalised industries' operations in this way;
- d. British Coal's poor past record in this area; and
- e. the difficulty of reconciling expansion abroad with contraction at home.

You will wish to consider whether these objections are decisive.



Supporting Coal R&D

14. Mr Wakeham says that the Government should continue to support the development of clean coal technology, and draw up and agree a future strategy for research and development (R&D) in this area. It is not clear whether Mr Wakeham is advocating something over and above what is already being done in this area, and you might ask for clarification. In any event extra Government support for coal R&D is unlikely to be a significant factor in helping the industry to cope with the problems ahead. You might want to suggest that any proposals for new R&D spending in this area should be dealt with through the normal process of consideration by independent advisory committees (ACORD and ACOST) and submission of bids in the annual PES exercise.

Privatisation

15. Mr Wakeham wants to leave on one side the question of any future privatisation, and says that his officials will make a presentation to him on the likely options "in the autumn". You might ask whether this has yet happened, and when he is likely to be able to bring forward proposals.

HANDLING AND NEXT STEPS

16. You may want to structure the meeting around the main headings of the annotated agenda:

- OVERALL OBJECTIVE, profit not volume;
- LEVEL OF CORPORATION'S FUTURE CAPACITY, which raises the question of the timing of closures;
- CORPORATION'S LONGER TERM FUTURE, which simply notes that environmental as well as market factors will tend to limit future prospects;
- GOVERNMENT ACTION, which covers restructuring grant and closures procedures, overseas expansion, research, and regular reviews of strategy;



- PRIVATISATION, which notes that work is in hand and suggests that decisions can be taken after the election.

17. If you are content with Mr Wakeham's general approach you might want to ask him, as Mr Major has suggested, to circulate the draft of the speaking note which he would use to communicate decisions to British Coal.

18. You might also wish to accept his suggestion that the strategy should be reviewed again in a year's time. Mr Major has asked that Treasury officials should be involved.

P F OWEN

19 October 1990