

PRIME MINISTER

FUTURE STRATEGY FOR BRITISH COAL

You are meeting the Chancellor of the Exchequer, the Energy Secretary and the Chief Secretary tomorrow for a discussion on the future strategy for British Coal.

At Flag A is a short note from the Energy Secretary (which you saw earlier) setting out the main items for discussion. This serves as a useful agenda. At Flag B is a briefing note from Cabinet Office. At Flag C is a note from the Policy Unit.

The main items for discussion are as follows:

- i. overall strategy;
- ii. level of British Coal Corporation's (BCC) future capacity;
- iii. BCC's long term market;
- iv. Government support;
- v. privatisation;
- vi. management.

i. Overall Strategy.

There appears to be broad agreement on the overall direction. BCC must no longer be output driven: the future strategy must be based on a return to profitability. The discussion should concentrate on the implications.

ii. Level of BCC's Future Capacity.

Until 1993, BCC's output will be largely determined by its contracts with the electricity generators. (Nearly 80 per cent of current output goes to electricity generation.) Thereafter, new contracts with the generators must be negotiated. The level of output post-1993 is bound to be largely determined by BCC success in those negotiations.

Success will depend on the competitiveness of the UK coal industry. That in turn will be determined in part by domestic unit costs and in part by the dollar exchange rate.

i. The note from Policy Unit explains that of the present 90 million tonnes per annum production, only about 25 million is competitive under almost any conditions (this includes 15m open cast). A further tranche of 15 million tonnes is probably irredeemably uncompetitive. The size of the UK industry in future will be largely dependent on progress in reducing the cost per tonne of the medium tranche of around 50 million tonnes per annum.

ii. At \$1.80 to the pound, this medium cost tranche would be uncompetitive; at \$1.40 it would be competitive. So the future exchange rate could be quite critical.

iii. BCC's Long Term Market.

There are a number of considerations. First, the long term availability of supplies at cheap prices on the international markets is relevant. Second, there are hints in both the Energy Secretary's minute and Policy Unit note that our relative competitiveness under tighter environmental controls might improve. Thirdly, there is also the factor of security of supplies, not just against coal but against other fuels, to be taken into account. What does this mean for the long term potential of the industry?

iv. Government Support

There are four main issues to cover here - the restructuring grant; the redundancy arrangements; possible expansion overseas; and coal R&D.

On restructuring grant, the present proposals make available a 90 per cent grant towards the costs which BCC incur in persuading miners to leave the industry. The Energy Secretary is bidding for this to be made up to 100 per cent. No decision needs to be taken at this stage: but the need for further

support, if major redundancies are to be achieved, should perhaps not be ruled out.

On redundancy provisions, such has been the difficulty in securing any change to the Independent Review Body (IRB) procedures that the Government would presumably wish to give no hint of substantive moves to dismantle those arrangements. That said, it seems premature to rule out such changes. Correspondingly, it also makes sense to seize every opportunity that arises over the next three or four years to make pit closures. As the Policy Unit note points out, postponing closures until 1993 simply makes the task more difficult.

On expansion overseas, there seems general agreement that this would be an unwise move. The benefits in terms of improving management morale do not outweigh the potential costs and disadvantages.

Finally, on coal R&D, Mr Wakeham proposes further support for clean coal technology. But it is not clear what Mr Wakeham is seeking. Any further steps should be considered by the normal independent advisory committees (ACORD and ACOST) and in public expenditure negotiations.

v. Privatisation.

Mr Wakeham's minute does not deal with this. But earlier Department of Energy papers implicitly seemed to assume privatisation as a single unit - a charge that Mr Wakeham's private office have since sought to deny.

The Policy Unit note spells out the options. Privatising British coal as a single unit is unattractive for all the obvious reasons. It would be a case of swapping a public monopoly for a private one. Similarly, attempts to privatise the individual pits does not make a lot of sense. It would certainly lead to a very small domestic sector, raising issues of strategy flexibility. Instead, as the Policy Unit note advises, some kind of regional company structure looks attractive.

But there is a more immediate issue. Selling open cast as a unit, despite the drawbacks noted in the Policy Unit note, is a sure revenue raiser. That could be important for PSBR reasons - as you know. Is it worth investigating further?

You will want to ask Mr Wakeham when he will be in a position to bring forward the options for consideration. One possible way forward might be to replicate the arrangements for British Rail: you may recall that a joint Ministerial DTp/Treasury group is looking at the options. Is this worth adopting for coal also?

vi. Management.

Finally, you may want to discuss the future management after Sir Robert Haslam. George Guise has put forward his own views in the Policy Unit note. You might wish to probe Mr Wakeham's latest thinking.

BHP

BARRY H POTTER

31 October 1990

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PRIME MINISTER

FUTURE OF BRITISH COAL STRATEGY

The meeting arranged for 10 a.m. tomorrow to discuss this has had to be cancelled.

Both the Chancellor and the Chief Secretary need more time to prepare for the ERM Debate.

The papers and briefing are ready. I will re-arrange the meeting as soon as possible.

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22 October 1990