

Ref. A0305

PRIME MINISTER

Strategy for the Coal Industry

(E(79) 45)

BACKGROUND

This is an important paper. It includes a number of expensive proposals and ties in closely with the decisions on public expenditure to 1983-84 which the Cabinet will be taking in the second half of October. It is also possible, though this is not dealt with in the paper, that the Committee will want to spend time on the related issue of the mineworkers' pay claim and the prospects for industrial trouble this winter.

2. In preparation for the meeting you may care to refresh your memory of the discussion in E on 17th July (E(79) 5th Meeting, Item 5). In your summing up of that discussion you recorded the Committee's broad agreement to three propositions:-

- (a) The desirability of accelerating the closure of uneconomic pits.
- (b) The need for continuing investment in those pits which had the prospect of profitability and high productivity.
- (c) The need to avoid a situation in which money provided for investment was diverted to meet current pay demands.

3. You also asked Mr. Howell:-

- (a) To seek to reach agreement with the Chief Secretary on the finance required by the NCB for the later years of the public expenditure programme.
- (b) To consider with the Chief Secretary and the Secretaries of State for Scotland and for Wales the rates of phasing out uneconomic capacity which might be realistically obtained in Scotland and Wales; to consider what investment would be required to develop high productivity pits in those countries; and to assess what levels of redundancy and redundancy payments were likely to be needed. The Secretary of State for Employment was to be associated with consideration of the latter issue.

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- (c) To consider with the Chancellor of the Exchequer the restructuring of the NCB's capital.
- (d) To examine and report to you on the measures which might be necessary to improve the management of the coal industry, not excluding questions about the structure of the NCB.

4. Some of these matters are dealt with in the paper and there has, so we are told, been contact between officials of the relevant Departments about them. But Mr. Howell's paper is silent on the question of whether any, and if so which, of his colleagues agree with his proposals. I think you should assume that most of them are not committed and, if this proves to be the case, it may be necessary to regard the discussion as a "Second Reading" debate rather than an occasion for final decisions.

5. However this may be, colleagues will all face the particular difficulty that Mr. Howell's proposals are effectively being offered as a single solution to a complex situation where many variations and alternatives are available. To put it crudely, colleagues may feel they are being asked to take the judgment of the NCB and Mr. Howell on trust - and to foot the bill - in a situation where many hundreds of millions of pounds are at issue in one of the most potentially explosive areas of the economy. At the least Mr. Howell must be made to fight his corner. Questions to this end might be:-

- (a) How much money is Mr. Howell asking for over and above the proposals which the Chancellor put to Cabinet two weeks ago for nationalised industry financing to 1983-84 (in C(79) 37) and which were generally endorsed by the Cabinet subject to bilaterals? The arithmetic is complex and cannot be derived from the Annexes to Mr. Howell's paper. Treasury understanding is that he wants about £50 million extra in 1980-81, about £100 million more in 1981-82 and reducing, though still positive, extra amounts to 1983-84, i.e. his proposals worsen the budget arithmetic throughout the life of this Parliament as against the Chancellor's hopes.
- (b) How realistic are the financial numbers quoted by Mr. Howell? The tables are in terms of constant 1978-79 prices and the assumptions about changes in real pay, prices and productivity are not stated. We believe

them to be: productivity plus 2 per cent a year. But quite small changes in these assumptions can have significant effects on the outcome - for example if miners' wages were to rise by 5 per cent a year in real terms the additional loss would be over £100 million, and if output per man year does not change (and it has moved very little in the last decade) the additional costs by 1983-84 could be over £100 million. The apparent precision in the financial forecasts therefore may be positively misleading. Faced with a not dissimilar situation of uncertainty in the steel industry Sir Keith Joseph is attempting to operate through financial targets, leaving it to the industry as the responsible body to work out its own salvation within that target. Colleagues will wish to consider whether the NCB's problem should be tackled in a similar way.

(c) It is relevant that the two financial projections in Annex 2 show losses, before grant but after interest payments, of £231 million in 1979-80, declining to £90 million in 1983-84 (on the 1½ million tons a year closure case) and to £113 million in 1983-84 (on the 3 million tons a year closure case). Is it acceptable to Ministers that the NCB should plan to remain in such substantial deficit throughout the quinquennium? The NCB, of course, has the endearing habit of talking of its results in terms of "operating" profits and loss without taking account of interest payments (which are largely offset by Government grants). But interest payments are made in real money and, when financed by Government, have to be paid for by real taxes. Moreover throughout the period the price of the main competing fuel, oil, is likely to be high and rising. If colleagues want to set a financial objective they will need to determine how far they can see a justification for continuing grant - e.g. to cover social costs - and whether they want to take on part of the burden through PDC (see below).

(d) Is it wise to base the strategy on a chosen level of colliery closures rather than on financial targets? During the major colliery closure period in the late 1960s the then Labour Government took great pains to avoid direct responsibility for individual colliery closures which were, it said, matters for the NCB to decide. Whatever the means - including assumptions on closures - which may be needed to calculate the

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realism of particular financial targets the Government will want to avoid closures becoming a matter where the NCB places responsibility on Government and thereby invites the NUM to treat direct with Government on them.

- (e) Is it really the case that an accelerated programme of colliery closures will worsen the NCB's financial results as far ahead as 1983-84? The NCB appear to have persuaded Mr. Howell that this is the case. But colleagues may want to be convinced that the cost of closing uneconomic pits are significantly higher than the savings made over so long a period.
- (f) Are colleagues prepared to see the introduction of public dividend capital (PDC) as a way of helping to balance the NCB's books? There is, on the arithmetic presented, little hope of dividends being paid on PDC over this period so that the proposal is difficult to reconcile with the normal criteria attaching to the creation of PDC. What is really being proposed is that a substantial part of the NCB's outstanding capital should be written off and cost of servicing it transferred to the Exchequer. This need make little real difference to the Exchequer if the Board's losses would otherwise continue to be financed, as now, by various forms of grant. But an element of discipline on the NCB would be lost as would such opportunity as there may be to make the industry service the capital with which it has been provided by the taxpayer.
- (g) Colleagues may well find the proposal for enhancing redundancy/transfer payments attractive as a means of reducing opposition to closure (British Steel experience is relevant here). But are they satisfied that the particular proposals do not have unacceptable repercussions elsewhere? It will be important to have the Secretary of State for Employment's view.
- (h) How does Mr. Howell envisage the NUM's current 60 per cent pay claim being handled? Are the NCB to be told that they must do the best they can within their existing cash limits and that under no circumstances will this be increased to accommodate pay settlements? As a corollary are the NCB to be left free to adjust their prices or cut their investment programme to make the books balance? And how vulnerable is the economy to a coal strike this winter? You will recall that at E on

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24th July (E(79) 6th Meeting, Item 3), you summed up a discussion about the prospects for this winter by stressing the importance of ensuring adequate supplies of coal to the power stations and asking the Secretary of State for Energy to keep you in touch with progress. You might care to ask for an up-to-date report to reach you very quickly.

- (i) Colleagues may also repeat the doubts which surfaced at your July meeting about the managerial competence of the NCB and the appropriateness of its present structure. At the end of that discussion (E(79) 5th Meeting, Item 5) you asked Mr. Howell to consider the matter and report to you. I am not aware that he has yet fulfilled this remit. Mr. Howell may of course have spoken to you privately about this but if not you could ask him when he proposes to do so.

HANDLING

6. You might ask the Secretary of State for Energy to introduce his paper and then call successively on the Chief Secretary, the Secretary of State for Scotland, the Secretary of State for Wales and the Secretary of State for Employment to make their contribution. If any of the points above have not surfaced you could throw them into the pool yourself. Thereafter much will depend on the way the discussion has gone. It may be (though I would personally doubt this) that colleagues will be prepared to accept Mr. Howell's proposals and explanations. It may be that they will be prepared to accept some of his conclusions - e.g. on improving redundancy pay and perhaps approving the investment programme - but have considerable doubts about the proposed financial strategy (where they might want to explore the alternative of setting specific financial targets designed to bring the NCB to genuine financial viability within a measured period) or the appropriateness of PDC. And it may be that they feel sufficiently uncertain to want to return to the whole matter again. In addition you are likely to see a deal of regional unhappiness about the employment and political consequences of closure patterns of the kind set out in Annex 1 to the paper, together with considerable uncertainty about the prospects of industrial trouble in the mining industry this winter. In these latter circumstances you might feel it better to avoid specific conclusions this time round and invite Mr. Howell to put in a further paper or papers dealing with the points raised in discussion. You will

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also want to ask him to distinguish particularly those decisions which are operationally urgent (e.g. the finance to be provided to the NCB in the years to 1983-84 where the Cabinet needs to have made up its mind by 25th October and the parameters to be set for the NCB in this winter's pay negotiations where they presumably need their marching orders pretty soon).

CONCLUSIONS

7. Very much subject to discussion, the Committee may conclude:-

EITHER

(i) To accept the Secretary of State for Energy's proposals subject to any modifications agreed in discussion

OR

(ii) To accept particular proposals - e.g. that at paragraph 9b. about improving redundancy payments but defer conclusions on the other proposals until further information has been provided by the Secretary of State for Energy

OR

(iii) To defer decisions on all of the Secretary of State for Energy's proposals until further information has been provided by him (you could use the questions in paragraph 5 above as a checklist). In this event the Committee will need to meet again, and have all the relevant information, immediately after the Party Conference if the Cabinet's public expenditure timetable is not to be jeopardised.

Additionally, the Committee may conclude:-

(iv) That it wishes to have an urgent paper from the Secretary of State for Energy on the handling of the miners' pay claim.

(v) That it wishes to have an urgent paper from the Secretary of State for Energy on the prospects for fuel supplies and stocks at power stations this winter.

And you may wish to ask Mr. Howell:-

(vi) For an urgent report to you about the management and structure of the NCB.

At E Committee in July, you asked Mr. Howell to keep you in touch with this: not a word since.

*JL
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J.H.
JOHN HUNT

26th September, 1979