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E(79)56
15 October 1979

COPY NO 56

CABINET

MINISTERIAL COMMITTEE ON ECONOMIC STRATEGY

STRATEGY FOR THE COAL INDUSTRY

Note by the Central Policy Review Staff

1. In considering E(79)50, Ministers may find it helpful to have a note bringing together

(a) the main assumptions underlying the strategy recommended by the Secretary of State for Energy.

(b) the points of disagreement between the Secretary of State and the Chief Secretary.

(c) some of the main issues which will need to be considered.

2. Assumptions

These are set out in Appendices 2 and 5 to E(79)50. Perhaps the most significant are:

- 2% p.a. increase in productivity.
- 3% p.a. increase in real earnings.
- 2% p.a. real increase in prices.
- annual closure rate of 1½ mn tonnes.

3. Points of Disagreement

(1) Recommended limits on external finance

£mn

	1980-81	1981-82	1982-83	1983-84
Secretary of State	628	597	531	434
Chief Secretary	598	570	480	375
Difference	30	27	51	59

Note

The Secretary of State would want to add the cost of any enhanced redundancy payments (up to £21 mn a year): the Chief Secretary would not.

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- to achieve a closure rate of 1½ mn tonnes a year would imply negotiating over a much larger capacity, given the inevitable appeals and reprieves. Is this realistic against an average closure rate of 0.8 mn tonnes over the past 5 years?

(2) Is there a case for PDC powers?

For new major long term projects there may be a case for PDC or deferred interest loans to match outgoings to revenues. But the case for converting existing debt to PDC seems very doubtful. It would certainly improve the appearance of the NCB's accounts but, with little or no prospect of dividends, it would be little different from a write-off of capital debt. Does this point to deferred interest loans as a preferable alternative?

(3) How will the strategy be enforced?

Given the uncertainties involved, there is clearly a risk that breakeven will not be achieved by 1984-85 on this prospectus. What, then, are the Government's options?

(i) take no disciplinary action and allow the cash limits to be broken. This would discredit the cash limit system and should, we think, be ruled out.

(ii) as the Secretary of State suggested in E(79)45, press for a faster phasing out of uneconomic capacity, perhaps with substantial changes on the Board. It is doubtful if this would significantly improve the financial position, at least in the short term. The proposed closure rate is in any case well above that achieved in recent years.

(iii) capital investment could be cut. But if the cut had to be substantial this would have damaging consequences (see Appendix 3 to E(79)50).

(iv) prices could be raised by more than the 2% p.a. in real terms assumed. But in paragraph 3 of Annex A to E(79)50, the Secretary of State proposes that revenue from higher prices should only be used as an extra contribution to self-financing (i.e. should not be used as a means of accommodating the consequences of higher wage settlements or lower productivity).

The CPRS suggests that the condition on the use of price revenues at (iv) above is artificial and probably unrealistic. This could

(2) The Secretary of State proposes that the following capital expenditure programme (set out in Appendix 3 of E(79)50) should be approved on the normal basis:

£mn 1979 Survey Prices

1980-81	1981-82	1982-83
587	575	583

The Chief Secretary recommends that approval should be delayed until the Board have accepted the financial limits he has proposed under (1) above.

(3) The Secretary of State recommends taking powers to issue Public Dividend Capital, their use to be conditional on progress towards viability. The Chief Secretary thinks no such provision should be made in the Coal Bill.

Issues

(1) Are the assumptions realistic? In particular

- are there solid grounds for believing that productivity will rise by 2% p.a.? Output per man year has been static in recent years at levels lower than in the early 1970s. If zero growth continued, trading losses could rise by, say, £200 mn a year by the fourth year (loss of 8 mn tonnes of output at over £25 a tonne). This, of course, would dwarf the differences shown in paragraph 3(1) above.

- even if the assumed 3% p.a. increase in real earnings is reasonable on average, how would it affect the financial targets if (as seems possible) much of it is bunched into the coming year? If the miners' settlement was, say, 20%, the additional shortfall could be £50 mn next year and probably more thereafter.

- there are at least two questions on the prices assumption

  (a) is the Board's assumption of a 2% increase p.a. in real prices compatible with their agreement (see footnote to Appendix 2 of E(79)50) to sell two thirds of their total production to the CEGB at a price indexed only to inflation? Depending on the precise terms of the agreement, the amount at stake could be over £35 mn in the first year, £70 mn in the second and so on.

  (b) the agreement with the CEGB apart, is there not more scope to raise coal prices than the 2% assumed, given the likely rises in oil and gas?

mean that the strategy would not be taken seriously by either side of the industry. It would be better, in the CPRS' view, to allow the Board to use the proceeds of higher price rises to offset operating losses (as with other nationalised industries) so that the consequences of excessive wage increases and lack of productivity growth are brought home sharply to both sides of the industry. This would be the best way of making the Board act commercially and would improve the chances of living within the Chief Secretary's financial limits. To reinforce the Board's bargaining position with the unions, the Government could consider making it clear that it would place no obstacle in the way of imports.

5. Conclusion

The CPRS recommends that Ministers should consider the questions raised in paragraph 4 above before settling the specific issues set out in the joint paper by the Secretary of State and the Chief Secretary.

Cabinet Office

15 October 1979