



Policy Study No 125

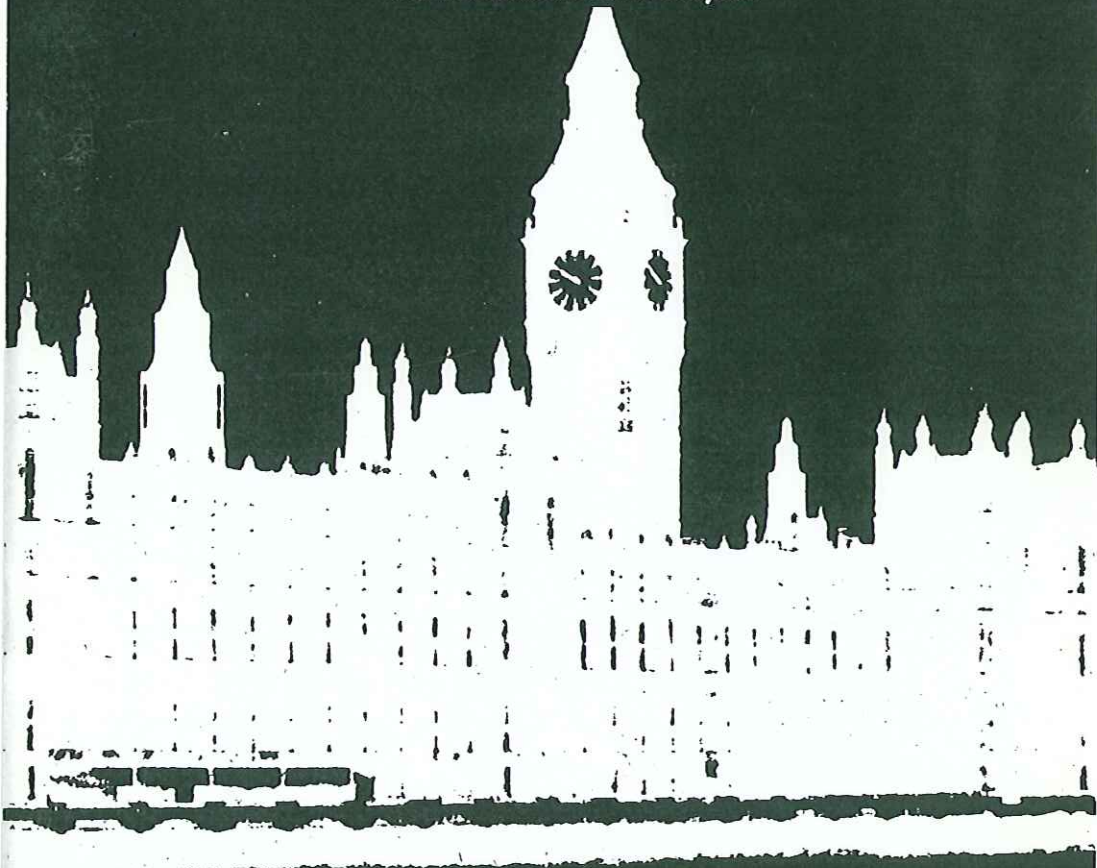
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# Competitive Coal

how to privatise coal  
and compete with imports

Colin Robinson and Allen Sykes



CENTRE FOR POLICY STUDIES

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## Foreword

In July 1987 the authors' *Privatise Coal, achieving international competitiveness*<sup>1</sup> argued that the British coal industry should be liberalised and privatised. Likely benefits were assessed, various forms of privatisation examined and a scheme suggested which would allow those benefits to be realised. Since then, the coal industry has remained in state ownership. Its output has continued to decline: in 1990 British coal production was only 93 million tonnes against 105 million in 1987. Coal is the only fuel supply industry still in state hands.

In the meantime, coal privatisation has moved higher on the political agenda. The Conservatives have promised it if they are returned at the next General Election. Since this is due by the summer of 1992 at the latest, we should consider with some urgency what form coal privatisation should take. Unless it is founded on clear economic principles, we may see another hastily-devised and ill-considered piece of energy privatisation. Little attention was devoted to establishing such principles in earlier energy privatisation schemes which resulted in a monopoly in gas and a duopoly in electricity generation. In both cases too little time was left for study and discussion, outside advice was neglected, and undue emphasis was placed on political goals. Consequently, the industries, their consumers and their regulators have met problems which, though predictable (and predicted), politicians had been unwilling to face.

This paper considers the reasons why coal privatisation has become politically acceptable, examines the reasons for privatising the industry, discusses various forms of privatisation and sets out a scheme capable of capturing the main potential economic benefits.

## 1.

# The background to coal privatisation

### The energy industries under nationalisation

Three of the energy industries — coal, gas and electricity supply — were among the 'commanding heights' of the economy nationalised by Clement Attlee's first postwar Labour Government: oil was regarded as too difficult because of the international nature of the oil companies' activities. Subsequent relationships, over more than forty years, between the state energy corporations and governments of both major political parties were uneasy<sup>2</sup> and the public images of the corporations were poor. There was concern about the considerable monopoly and monopsony power wielded by the British Gas Corporation. In electricity supply, decision-making was heavily politicised. The industry was used by governments to support the British coal industry, British-designed nuclear power plants and British power plant manufacturers: it was frequently and fairly accused of technological backwardness and unresponsiveness to consumers.

### Coal under state ownership

By far the biggest problem, however, among the nationalised energy industries lay in coalmining. The state corporation (the National Coal Board, renamed British Coal Corporation in 1986) made big losses, especially in the 1980s<sup>3</sup>, and drained state finances. Relations between the corporation's management and governments were often tense and, except in the 1960s, management-worker relations were strained. There were serious national strikes in 1972 and 1973-74, the latter generally considered to be a factor in the defeat of the Heath Government.

Then in 1984-85 came a year-long strike, with strong political overtones, which ended in victory for the Government. The decline in employment accelerated, though there were no compulsory redundancies. On the eve of the strike 180,000 miners were working in 170 pits; there are now fewer than 60,000 miners and soon only 62 pits will be open<sup>4</sup>. There has been little opposition to the many pit closures, and no major strikes since 1985 despite the rundown of the industry and despite the privatisation of the electricity supply industry which is British Coal's principal customer. Production has fallen much less than

employment: output per manshift has approximately doubled in the six years since the end of the strike.

The downward trend in British coal production had in fact started in 1913, and continued between the First and Second World Wars as export sales fell. There was a further drop during the Second War when the industry lacked resources. But in the years immediately after 1945, coal was seen as the principal source of energy for the British economy. A widespread (if misguided) belief was that coal production should be expanded to avoid a future 'energy gap'<sup>5</sup>.

After a few years of recovery, however, the decline in production resumed — accelerating from the late 1950s onwards. From 1957 onwards home demand began to contract rapidly as first relatively cheap oil, and then natural gas, took over in all its markets other than electricity generation.

Figure 1 (overleaf) traces the decline in British coal production since the beginning of the century. In 1913, production peaked at 292 million tonnes; the postwar peak was 228 million tonnes in 1952; but by 1990 production was only 93 million tonnes.

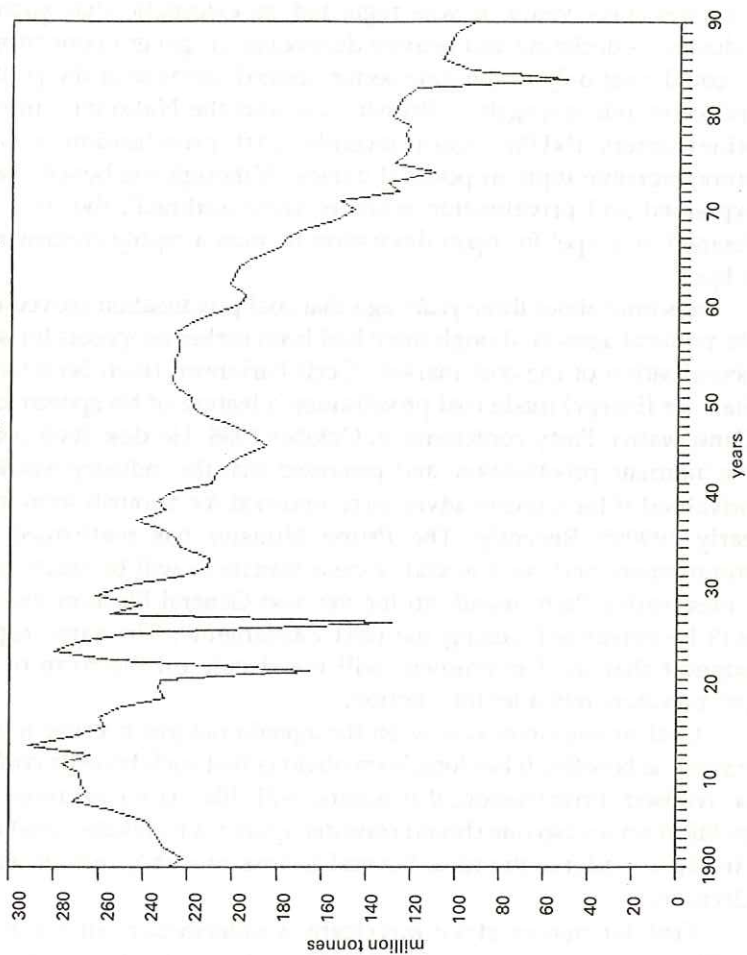
Coal's share of indigenous fuel production declined from virtually 100 per cent to 27 per cent between 1950 and 1990. (Two thirds of indigenous fuel production is now oil and gas from the North Sea.) And its share of Britain's growing energy market fell from 87 per cent to 30 percent over the same period. (Table 1)

The sharp postwar decline in coal occurred even though governments protected it from competition by insisting that the Electricity Boards buy British coal, by limiting coal imports, by taxing fuel oil and by giving grants to firms which converted from oil or gas to coal. The industry's debts were also written down on several occasions. Just before the 1984-85 strike, government aid was running at about £1 billion a year. Nor was the industry starved of resources despite its financial condition. In the early 1980s, investment averaged about £700 million a year (about £1300 million a year in 1991 prices): twice or three times the investment in the (then) West German mining industry — which was of comparable size<sup>6</sup>. In recent years investment has been running at about £500 million a year.

Governments justified protection for coal and the high level of investment (far higher than return on capital warranted) on the grounds of increasing security of fuel supply, safeguarding against oil price increases and improving the balance of payments. Such claims had little substance<sup>7</sup>. In effect, a political insurance premium was being

paid to keep quiet a particularly militant trade union for whose members there was, until the 1984-85 strike, much public sympathy. Now that union militancy has subsided and for other reasons examined below, coal privatisation is firmly on the political agenda.

Figure 1  
**UK COAL PRODUCTION (deep mined and opencast)**



## 2.

# Coal privatisation on the political agenda

For over forty years, it was regarded as axiomatic that such an industry — declining and heavily dependent on government support — could exist only in the state sector. Indeed, because of the political and economic strength of British Coal and the National Union of Mineworkers (NUM), until recently coal privatisation was an unmentionable topic in political circles. Although the benefits were explained and privatisation schemes were outlined<sup>8</sup>, the time was deemed 'not ripe' for open discussion of such a highly controversial subject.

It is only about three years ago that coal privatisation moved onto the political agenda, though there had been earlier proposals for some liberalisation of the coal market<sup>9</sup>. Cecil Parkinson (then Secretary of State for Energy) made coal privatisation a feature of his speech to the Conservative Party conference in October 1988. He described coal as the 'ultimate privatisation' and promised that the industry would be privatised if the Conservatives were returned for a fourth term in the early 1990s<sup>10</sup>. Recently, The Prime Minister has reaffirmed that commitment and, so it is said, a clear statement will be made in the Conservative Party manifesto for the next General Election that coal will be privatised during the next Parliament<sup>11</sup>. The same reports suggest that the Government will not decide on the form of coal privatisation until after the Election.

Coal privatisation is now on the agenda not just because it offers economic benefits; it has long been obvious that such benefits could be so realised. Privatisation, if it occurs, will (like nationalisation) be a political act and so one should consider what has motivated politicians finally to endorse the idea. Several factors probably influenced the decision.

First, the miners' strike was clearly a watershed. Even in the early 1980s, government seemed unwilling to act in ways that might upset management and provoke unions to strike. In 1981 a threatened strike led to a tactical retreat by Mrs Thatcher's first administration which had proposed to reduce state protection for the industry: instead, protection was increased<sup>12</sup>. Memories of Mr Heath's experience in 1974



were then still fresh in the minds of those in government. But the result of the 1984-85 strike began to erase such memories.

The rapid decline in coalmining employment since that strike and the general feeling that British Coal has a bleak future have eroded the lobbying power of the industry<sup>13</sup>. Coal is no longer a political and economic force feared by government. Effective opposition to privatisation from within the industry seems largely to have evaporated. Some senior managers are openly in favour<sup>14</sup> and, since probably not many union members would be actively opposed, their leaders might prefer to seek the best deal available, rather than oppose privatisation *per se* — following the precedent of the electricity supply workers.

Second, electricity privatisation has forced the issue of coal privatisation. The two industries are so linked — about two thirds of the generating capacity both of National Power and PowerGen is coal-fired and a further tenth is dual coal-oil fired (Table 2) — that privatising one was bound to have a direct impact on the other. Parallel privatisation of the two industries would have been desirable, but the time is now past for that. The electricity distributors (Regional Electricity Companies) are now entirely in the private sector. So are the two Scottish electricity companies. And 60 per cent of the shares in National Power and PowerGen is in private hands.

Government-inspired initial three year contracts will maintain British Coal sales for electricity generation at near their previous level until 31 March 1993<sup>15</sup>. But after that time the private electricity companies will, for cost and environmental reasons, wish to reduce their input of coal from British mines. Paradoxically, the dependence on coal which the state forced on the nationalised electricity supply industry reduced the security of the industry's fuel supplies, and turned it into a major polluter of the environment. Reducing that dependence will be one of the main goals for the private electricity supply industry in the 1990s. British Coal will pay a high price for its long period of heavy state protection<sup>16</sup>.

Third, the coal industry has brought so many awkward problems to governments since the war, and has so drained state finances, that politicians have a strong incentive to move it into the private sector, shedding their direct responsibility for its activities. Though industrial relations in coal may not be so stormy in the 1990s as in the 1970s and early 1980s, mining is a risky business (which makes it unsuitable for investment of taxpayers' money). Substantial investment (perhaps

about £500 million a year at present day prices) may well be required in the next ten years. Given all the calls on public spending, the political benefits of such an industry raising its capital privately are obvious — whichever party is in power. Labour might well not itself privatise the industry. But there is no reason to believe that it would re-nationalise coal if the Conservatives had privatised it; although it might try to re-institute a degree of protection for coal in electricity generation<sup>17</sup> (unless it has been genuinely converted to a belief that efficiency is best pursued through market forces).

### 3.

## Objectives of coal privatisation

### General objectives

The four main objectives in British privatisation are widening share ownership, raising revenue, depoliticising decisions in the industries concerned and liberalising markets.

Share ownership has certainly been widened (though not deepened) by well-publicised flotations in which shares in privatised corporations have been offered — in the event almost always at a substantial discount to initial market valuations. In addition, employees and customers have generally been given special deals and applicants for small numbers of shares have been favoured in order to spread shares to as many people as possible. Thus many have had an unfamiliar choice: either to sell newly-acquired shares at a profit, or to hold them in hope of seeing their value grow. Few first-time shareholders have been converted to shareholding as a habit: most hold only the privatisation issues which they bought on favourable terms. Though economists may argue that subsidising share ownership in this way gives the owners a false impression of 'true' share ownership, the political benefits are obvious.

Revenue-raising has also been a very important political objective. It soon became clear that, despite the discounts at which shares were offered, privatisation enabled government to raise large revenues which helped to reduce both public borrowing (which seemed particularly desirable in the early and mid-1980s) and taxes.

Privatisation with its change of ownership inevitably led to reduced politicisation in the running of the companies concerned. For years governments had intervened in the pricing and investment plans of nationalised corporations, to the extent that managements felt themselves continually second-guessed by politicians and civil servants and was unable to manage. One element in the privatisation programme was the deliberate relinquishment by government of such power.

Market liberalisation had only a low priority in many privatisation schemes. 'Product market' liberalisation, which most economists regard as the most important source of benefits from privatisation, was pursued half-heartedly. Nor were capital markets allowed to operate freely. The Government was reluctant to allow newly-privatised companies to enter the market for corporate control.

Typically, a government-held 'golden share' allowed it to veto a change of ownership (though the veto was not exercised in the cases of the Ford takeover of Jaguar and BP's takeover of Britoil) and in some cases limits were put on the size of individual shareholdings. Generally the method of privatisation excluded trade sales (and hence the early injection of new management blood). Thus one important way of increasing the efficiency of privatised concerns was ruled out, and effectively self-perpetuating Boards of Directors remained, in some cases co-existing with union monopolies.

Market liberalisation had such low priority because it was seen as yielding lower political returns than pursuit of wider share ownership and revenue-raising<sup>18</sup>. Indeed, it often conflicts with the latter two objectives. The more a product market is liberalised, other things equal the worse the earnings prospects for the companies concerned, the less attractive the shares and the smaller the revenue likely to be raised from flotation. There is no organised constituency in favour of liberalisation but there are many organised groups against it as well as politicians. Senior management of the corporations concerned, while welcoming the freedom and higher salaries which privatisation brings, will want to retain their market power. Unions will be happy that they should do so, since in general better deals can be concluded with a monopoly than with a firm in competitive conditions. Both groups will also favour golden shares to provide a quieter life. The City, though not favouring restrictions on takeovers, finds it easier and far more profitable to float product market monopolies. Thus at any moment there is likely to be a powerful coalition of interests against market liberalisation.

### **Objectives of energy privatisation so far**

In the energy privatisation programme so far, this unholy alliance has prevailed. British Gas was transferred into the private sector in 1986 with its market power undisturbed. Only through the efforts of the Monopolies and Mergers Commission<sup>19</sup> and James McKinnon, the industry regulator<sup>20</sup>, has a limited degree of competition gradually emerged in the British gas market though it is now nearly five years since flotation.

The electricity supply scheme was less obviously monopolistic. Entry to the industry became possible (though difficult), a separate transmission company was established which allows entrants to reach consumers, and generation was divided. Division, however, into only

two large generators (National Power and PowerGen) established two powerful incumbents in an industry whose pre-existing network of relationships remained largely in place. The duopoly was originally designed to find a home for British nuclear power stations in the larger company (National Power) where they would not be too noticeable. But it remained even after the capital markets vetoed the attempt to privatise nuclear stations and it is a serious deterrent to entry into electricity generation and supply.

### **Objectives of coal privatisation**

The best form of privatisation is for British Coal to be divided into a number of coal companies. In economic terms, its privatisation is more straightforward than gas or electricity if only because it contains no network 'natural monopoly' elements, such as are constituted by the networks of gas pipes and electricity wires.

There are no such complications in the case of coal mining. Political considerations dictated that the industry should be nationalised as one unit and should subsequently be run by a single corporation. But there are no economic reasons why it should remain as a single unit. A number of advantages would indeed be likely to flow from division.

### **Benefits from division**

First, competition (both in product and capital markets) would protect consumers from exploitation and shareholders from inefficient management. An industry in which there existed rivalry between a number of British coal companies would bring the advantages which stem from the competitive process: entrepreneurship and innovation would be stimulated, performance standards would be set by the activities of competitors, costs would tend to fall, and prices would be more closely aligned with costs than now.

Second, division of the industry would lead to more decentralisation. The presence of a single large organisation spurs its suppliers — of labour services and of equipment — to make similar organisational arrangements, in order to establish countervailing power. The formation in 1944 of the single union (the NUM) which used to exist in coalmining arose in part from the imminent establishment of a single coal corporation. A decentralised coal

industry would stimulate more competition in supplies. Wage bargaining has already decentralised to some extent in recent years: the process would go further in a competitive coal industry. Competition in equipment supply would also be stimulated.

Third, if coalmining is divided and competition introduced, regulation can be limited to pro-competition regulation — which can be left to the Monopolies and Mergers Commission. That would be a great advantage since regulation, though necessary with genuine natural monopolies, is always unsatisfactory, trying as it does to simulate the outcome of competitive conditions where they do not exist. Since coal is naturally competitive unless a monopolistic structure is imposed on it, regulation is unnecessary.

A more efficient (and probably larger) British coal industry will therefore emerge if British Coal is broken up on privatisation rather than retained as a monolith.

### **Political calculations**

So much for the practical economic arguments for division. Nor do political calculations point to maintaining the coal industry intact. The familiar pressure groups will declare themselves in favour of a unitary form of privatisation — the industry's management, the unions and the City. But, given the recent coal rundown, management and unions have much less power than the corresponding organisations in gas and electricity.

In any case, since the Government's main objectives in earlier privatisation schemes — raising revenue and widening share ownership — will probably not be furthered by any likely form of coal privatisation, its own interests do not point towards unitary privatisation. Nor is there likely to be a big flotation involving the City. Shares in a single British coal company are unlikely to be attractive to a general public accustomed over many years to hearing about poor industrial relations in British coalmining, poor finances and poor demand prospects from the privatised electricity generators.

Almost certainly, therefore, privatisation will need to be by a 'trade sale'. Consequently, widening share ownership will probably not be an issue in coal privatisation. Nor is revenue-raising likely to assume the significance it did in earlier privatisations. Although trade buyers would be likely, other things equal, to pay more the greater the market power of the organisation they purchase, coal will not provide

the billions yielded by the gas and electricity privatisations. The Government will, as explained earlier, have good reasons for wanting to dispose of coal to private owners and revenue will not be a major consideration.

**Counter arguments: effects of the generation duopoly**

In answer to the case for division on privatisation, there are two counter-arguments which may be put. First, it is sometimes suggested that the electricity generation duopoly makes it necessary to maintain countervailing power in coalmining: otherwise, it is claimed, the duopolists would dominate a broken-up coal industry. If that is so, it is much more a comment on the form of electricity privatisation than it is on what form of coal privatisation would be appropriate. The remedy is to take steps to inject more competition into electricity generation rather than to throw away the benefits which could be obtained from liberalising coal.

Two earlier papers of ours (preceded and succeeded by numerous discussions with Energy Ministers and officials)<sup>21</sup> went to some lengths to point out that an illiberal scheme of electricity privatisation could easily pre-empt the decision on how to privatise coal. However, that is not to say nothing can now be done to make the electricity scheme more liberal. If it is correct, as claimed, that there is so little competition in electricity generation that coal can only be privatised as a single unit, the absence of competition constitutes a serious issue anyway: National Power and PowerGen must have excessive power relative not only to the coal industry but also to potential entrants to generation and to their customers and other suppliers.

Thus steps are needed, whether or not coal is privatised, to ease entry into electricity generation and to ensure that the two generators do not dominate their customers and their suppliers. The main problem is that National Power and PowerGen, either by manipulating the electricity 'pool'<sup>22</sup> or by other means, will deter entry and thus make permanent a situation in which there is only minimal competition in generation. If there is any suspicion that they are so acting, plainly they should be referred to the MMC: one consequence of such a reference might be a break-up of both organisations. Any such monopolies inquiry should be started in time to reassure potential purchasers of coal mines — either because National Power and PowerGen are broken up or because the MMC determines that they are not guilty of anti-competitive behaviour.

### **Counter arguments: competition from other fuels and coal imports**

The other argument against break-up, commonly used by British Coal's senior management, is that it is unnecessary. On this view, a privatised British Coal would be sufficiently exposed to competition from other fuels and from coal imports. Thus the benefits of competition would appear even with only one British coal company.

There is a sense in which maintaining Coal whole on privatisation would have less unfortunate effects than the monopoly privatisation of British Gas since coal is an internationally traded good whereas the British gas market has for years been separated from Continental gas markets (though one may hope it will not remain so). Nevertheless, privatising Coal whole would, for the following reasons, fail to gather most of the benefits otherwise due.

First, although there would be competition from other fuels and from coal imports, there would be no rivalry in the mining and marketing of the overwhelming proportion of British-produced coal. There has been only one organisation in control of such activities for the last forty-five years. It is time for the injection of new ideas which are much more likely to come from several new organisations with new management competing to produce coal as cheaply as they can in British conditions. One of the main functions of the competitive process is to provide a mechanism which continually sets higher standards. However good British Coal's management may be, it cannot be expected to reproduce that process within a single organisation nor to draw upon the wide body of international mining and market experience available to trade buyers.

Second, the benefits of decentralisation and increased competition in associated markets for labour and equipment would not appear if there were only a single coal company. Since the change would be only in the ownership and not in the structure of the coal industry, there is no reason to expect any changes in these associated markets.

Third, if British Coal were transferred undivided to the private sector, it might at times enjoy excessive market power despite an apparent exposure to competition from the world coal market and from other fuels. In recent years, coal imports have been able to penetrate the British market (when government has permitted). Many British mines have closed as a result. But if an industry is being restructured, we must look beyond existing circumstances to ensure that the new structure is robust when up against changing conditions. It is quite conceivable, given the degree of transport cost protection



which the British central coalfields enjoy, that in certain states of the world coal market and at an exchange rate relative to the US dollar much lower than now, it might be very difficult for imports to compete in Britain. In such circumstances, the presence of several competing British coal companies would be an important safeguard for consumers.

## 4.

# The privatisation options

### Sale to the public?

The coal industry is a risky, capital-intensive business with no elements of natural monopoly. Following the privatisation of electricity supply, the private generating companies (unlike their predecessor, the Central Electricity Generating Board) will be free to choose their strategies in generating and in fuel purchase. There are several reasons why an attempt at public flotation is undesirable.

First, future demand is very uncertain — much more so than it was for gas and electricity when they were floated.

The demand for opencast coal may indeed remain static (about 18 million tonnes a year) or even grow because it is the cheapest coal on the British market and will remain so. Whether or not supply can match demand turns principally on how far planning authorities are willing to consent to further opencast operations.

But it is much more difficult to predict the future of the underground mines after the three year contracts with the generating companies run out in March 1993. There now appear to be firm plans to build large coal import terminals on the Tees, the Humber and at Liverpool<sup>23</sup>: once constructed, those ports will enable the generators to bring in large quantities of overseas coal whenever it is cheaper than British coal. The generators plan to meet the EEC's sulphur emission standards (which require a 60 per cent reduction in sulphur dioxide emissions by the year 2003 compared with 1980) by importing relatively low-sulphur coal. They also plan to use natural gas in new Combined Cycle Gas Turbine plant and to fit 4 GW each of flue gas desulphurisation equipment at existing coal stations<sup>24</sup>.

The ability of British deep mines to compete in these circumstances depends on the form and effectiveness of privatisation and the competence of their owners and managers. What is clear is that, as the world coal market changes and as sterling fluctuates against the dollar (in which internationally traded coal is priced), the price of imported coal may well undergo significant variations. Flexible and imaginative management will be needed to cope with the effects of such variations.

A second problem in any public flotation is the uncertainty of costs. In particular, given the troubled history of labour relations in the

industry, potential investors would be unsure how the miners and their unions would respond to a decision to privatise coal. A national strike is unlikely but to the general public might well seem a threat. In the longer term, there might be concern about the morale of miners after privatisation and their willingness to accept new technology and working practices. The authors are optimistic on such matters, particularly if privatisation introduces experienced and competent international mining companies and provides incentives for management and all workers in the industry. But shares in British coalmining would probably not be attractive to a wide public.

Third — giving further rise to uncertainty over costs — British underground mines will need large capital expenditures to modernise equipment (especially underground transport), sink new shafts, expand workings and improve productivity. At present prices and exchange rates, British coal is about 50% more expensive than imported coal. Import prices are around £30 per tonne (the figure suggested in the authors' *Privatise Coal* which the British coal industry would need to meet in the early 1990s) whereas British coal averages over £40 per tonne at the mine. The necessary productivity improvements are bound to take time. In the meantime, cash flow will be much more difficult to predict than in the cases of gas and electricity.

The fourth reason why British coalmining is an unsuitable candidate for public flotation follows on the above. Because of the large capital expenditure which will be required — perhaps towards £500 million a year — the companies might well wish to make rights issues every two or three years. That alone virtually rules out sale to the general public. Most of those who have subscribed for previous privatisation issues have either sold for a quick profit or, if they have held on to their shares, hold little or nothing else. Those who are not confirmed shareholders, are unlikely to look kindly on frequent calls for rights issues. They might well prefer either to sell or refuse to subscribe (even to their own detriment).

For all these reasons, it seems unlikely that the Government will attempt a public flotation for coal. The proposition will not be attractive enough to the public to justify pursuit of the political objectives of widening share ownership and raising revenue — the Government's principal aims in previous privatisations.

#### **The main privatisation options: opencast coal**

Opencast coal, most of which will be competitive with imports at any

likely prices and exchange rates, will be relatively easy to privatise. Opencast operations require quite different skills and techniques from deep mining. They are essentially the province of earth moving contractors, and the workers belong mainly to the Transport and General Workers' Union rather than to one of the mining unions. The purchase of opencast pits would thus appeal to the contractors who now work for British Coal; the pits could be sold off as a separate package, regardless of the form in which underground mines are privatised. Alternatively, if underground mines are sold by region, it would be possible to include in the sale the opencast sites in each region. Though the second alternative has attractions<sup>25</sup>, the balance of advantage lies in selling opencast mines separately by tender. Contractors with experience in the field are most likely to be able to improve the efficiency of opencast mining — and would probably be among the highest bidders in any tender.

#### **Privatising the underground mines**

The main options remain as specified in *Privatise Coal*. They are to:

- privatise British Coal as a single corporation
- auction underground mines on a mine-by-mine basis
- sell underground mines in suitable groupings, for example on some form of regional basis

#### **Sale as a monolith**

Selling British Coal as a single entity would be the simplest form of privatisation and would no doubt be appealing to existing employees. But replacing a state monopoly by a private one would lessen the pressures for the uncomfortable changes which are necessary. It would preclude the rapid injection of technical and managerial expertise, and the demand for indigenous coal would be lower than it need have been, with corresponding adverse effects on employment in the industry.

Although British Coal has almost doubled productivity since the end of the 1984-85 strike, productivity needs to improve much more relative to earnings, if underground coal production in Britain is to be competitive against imports at present world coal prices and existing exchange rates. Such improvements are possible since productivity in comparable underground mines in the United States, for example, appears to be well above British productivity<sup>26</sup>. But to achieve them at

speed, and so to avoid many more pit closures, requires the involvement of international mining companies.

Of course, it might well be possible to sell British Coal as a monolith either to one company (for instance, a mining or construction group) or via a management or staff buyout. The benefit from selling to a single corporation is that it could bring management, financial, technical and commercial expertise as well as the resources needed to finance large capital expenditures. However, such a sale would be much inferior to a sale to at least three or four different groups which, as explained, would provide the stimulus of competition and the input of a wider variety of experience than could be provided by a single company.

Monolithic sale to management or to all employees has little to commend it. It would bring in no new expertise and, given the recent low profitability of the industry, and the likely withdrawal of government subsidies, it might prove a financial disaster. Existing management has no experience of running an industry which has to compete without the aid of extensive government protection and it seems unlikely that it could attract the large annual input of funds needed for the enterprise to survive. Presumably the Government will not take such an option seriously given the risk that British Coal, privatised in this fashion, might move swiftly towards bankruptcy.

### **Sale mine-by-mine**

Such a scheme has much more to recommend it. It would be of interest to a range of firms, and perhaps to many existing managers and workers who would be able to bid for individual pits. Pits would be allocated to those who placed most value on them, and the competitive market which would result should lead both to improvements in efficiency and to lower prices for energy consumers.

But, as *Privatise Coal* argued, the practical problems of such an approach are serious. Formidable technical and legal problems would arise in drawing up prospectuses for over 60 mines and other businesses. Delays could be lengthy, leading to uncertainty about the outcome of privatisation and making companies reluctant to bid. Furthermore, a multitude of bids, with no certainty of obtaining economic groupings, might well deter potential bidders, both in Britain and abroad. Efficient world-scale mining companies are much larger than the largest British deep mines. Drawing the boundaries for the coal reserves attributable to particular mines (an essential

prerequisite to sale but unnecessary in the state-owned industry) would also present problems and cause delays.

Thus, despite the attractions of this approach to privatisation, it would be difficult to implement. In particular, it might deter those companies most likely to be able to bring managerial and technical expertise to British coalmining — and most likely to improve its efficiency in the medium to long term.

### **Selling by regions**

An industry able to compete with imported coal and with other fuels, both in power generation and in other markets, would be more likely to emerge if coal was sold by region rather than pit by pit.

British Coal is now divided into Groups, rather than the nine Areas which existed in 1987. In the Corporation's last published Report and Accounts (1989-90), the nine Groups are shown divided into two Regions. The Scottish Group, however, has been disbanded since only one deep mine (Longannet) remains in Scotland. Moreover, few mines remain in the South Wales Group, and none in the Kent Group. Most of British Coal's output is concentrated in six Groups:

<i>Group</i>	<i>Million Tonnes (1989/90)</i>
North East	10.3
North Yorkshire	13.9
South Yorkshire	11.1
North West	7.0
Nottinghamshire	16.8
Central	10.9

Groups differ in size and efficiency and present boundaries need not be used to define regions for privatisation. Four or five regions need to be drawn up, as close to existing boundaries as makes economic sense and of comparable size. The task of dividing reserves among the regions will then be relatively straightforward. Although some of the regions will inevitably be more attractive than others that simply means they will attract higher prices. Allocation should be by tender, allowing bidders to tender for more than one region and to state their preferences. But on grounds of competition, no one should be allowed to purchase more than one region, except perhaps for small regions (or single pits such as Longannet).

Likely purchasers would be international mining companies,

based in Britain or overseas, with experience in underground mining. They would have the best chance of increasing efficiency in British coalmining and would be likely to make the best tenders.

Nevertheless, smaller organisations should not be excluded. The new regional coal companies may well wish to sell some of the operations which they acquire. Thus there would be opportunities for the relatively small but vigorous existing private mining sector, for managers wishing to buy out and for employees wishing to form co-operatives. The Government should aim by the late 1990s to have a competitive coal market, not dominated by any one seller or group of sellers. There might, say, be four large companies producing 10-12 million tonnes a year each, many smaller companies and a licensing system for new reserves which permits fairly easy entry to coalmining in Britain.

#### **Should the generators be allowed to bid?**

National Power and PowerGen are at present contracted to take, between them, a minimum of 70 million tonnes from British Coal in 1991-92 and 65 million tonnes in 1992-93. Should they be allowed to bid for power stations?

In many parts of the world, power stations are supplied in whole or in part by coal mines which they own. If the Government had privatised coal and electricity supply in parallel (as would have been best) competitive generating and coal industries, in which some companies owned both power stations and coal mines, might well have been established. That opportunity, however, was lost — as was the opportunity to break up the CEBG into five or six parts on privatisation<sup>27</sup>. Had it been taken, bids by generators for coal mines might have been allowed (though it would have been necessary to watch out for anti-competitive practices).

Instead, the Government established a generation duopoly strong enough to cause the complications for coal privatisation set out above. Unless the Government decides (perhaps after a Monopolies and Mergers Commission investigation) that a break-up of the two generators, which are already too powerful, is required for the sake of competition, they should not be permitted to bid for coal mines.

#### **Should coal be protected against the generating duopoly?**

The market power of National Power and PowerGen against a broken-up coal industry is sometimes given as a reason for privatising

British Coal as one unit. This power arose because the Government failed to listen to advice that its method of privatising electricity would prove a handicap in the efficient privatising of coal; it may have been that it was simply too pre-occupied with the problems of ensuring a successful float for electricity. Whatever the reason, the presence of two major generators with market power will be a deterrent to investment in British coal mining. Better to reduce the power of the generators National Power and PowerGen (by break-up if necessary), rather than permit privatisation of a coal monopoly in an attempt to establish countervailing power vis-a-vis.

### **Would imports flood the market after privatisation?**

From April 1993 the two major generators will be free to purchase coal where they will. But, as *Privatise Coal* explained, there is no need to fear that the bulk of the market will be taken by imports. Lower transport costs protect the central coalmining areas against imports, except in supplies to coastal power stations; the generators will not wish to be too dependent on imports, partly for reasons of security and partly because buying British coal offers protection against exchange rate fluctuations; and if generators did attempt to purchase most of their requirements abroad, they would soon find imported coal rising in price.

For the near future British coalmines are likely to provide 50-60 million tonnes a year. If opencast output expands, say to 20 million tonnes, deep mined production might be upwards of 30-40 million tonnes. But if experienced mining companies buy the main underground regions and costs fall well below their present level, annual deep-mined production could be much higher — perhaps 50 million tonnes or more. British coal production has been in the hands of a single nationalised corporation for 45 years: once several companies are competing with each other savings in costs might be very considerable. The gains from liberalising markets are often, if not always, underestimated.



## Preconditions for successful privatisation

The essential preconditions are these:

### *Licensing coal reserves and mining activities*

Since the end of the war a small private coalmining sector<sup>28</sup> has continued in being despite the severe constraints placed upon it. Until very recently, private underground mines were restricted to only thirty workers underground, they had to obtain licences from British Coal (their nationalised competitor) and had to pay royalties to British Coal (which did not itself pay royalties to the Government). In addition, the CEEB paid less for coal from this small private sector than from British Coal. A recent EEC judgment found that discrimination against small mines under power generation coal contracts was illegal. The Government is now endeavouring to avoid legal action by the EEC Commission by arranging for price increases for private coal and by reducing the royalties paid to British Coal<sup>29</sup>.

In 1988, the then junior Minister in the Department of Energy, Michael Spicer, said that the Government was considering relaxation of the principal restraints on private mining<sup>30</sup>, and some relatively minor relaxations were indeed made. It is now possible to employ 150 people underground in a private mine. It is, however, absurd to restrict the private sector in this way and to make it dependent on a state corporation for licences. In the interests of justice and efficiency, all restrictions on private mining should be lifted immediately, thus enhancing competition in the industry before privatisation. Such a measure would not unduly reduce proceeds from privatisation.

The Government should also insist that, whilst British Coal exists, it should be obliged to offer to sell to the private sector any pits which it contemplates closing. Small companies might well be able to work some coal deposits profitably, even if British Coal cannot: at least entrepreneurs should have the opportunity to try.

On privatisation, ownership of Britain's coal reserves should be transferred from British Coal to some organisation — either a civil service department or an independent agency — which would be responsible for licensing unmined reserves. A 'Crown Coal Commission'

could, for example, be established on the precedent of a 1938 body of that name<sup>31</sup>. There should be a liberal licensing regime for all reserves other than those allocated to the companies tendering under the privatisation scheme.

The Crown Coal Commission could also assume responsibility for subsidence claims, past and future. The latter could be met from the proceeds of a levy per tonne on the underground mining companies. This might be rather rough justice but it would avoid holding up privatisation because of disputes over such claims.

#### *Renewing coal contracts beyond April 1993*

Unless the Government quickly tackles the duopsony power of the two major generators, some extension of existing contractual arrangements between generators and coal mines beyond March 1993 may be necessary, if interest among potential trade buyers is to be excited and transition to private ownership is to be at all smooth. The new contracts would be either with National Power and PowerGen, or with their successors if the two generators were being broken up. These contracts should be confined to the output of mines capable of commercial survival after the freeing of coal imports. The new owners will need some limited period of assured income, if they are to justify investing in underground mines, with all their problems, and to plan the necessary productivity improvements. There could, for example, be initial contracts for minimum quantities (shared among the generators) of, say, 50-55 million tonnes a year, falling by 5 million tonnes a year over three years to 35-40 million tonnes a year, with prices reducing year-by-year from today's contract prices towards parity with imports. Thereafter, the market would be entirely free.

It is true that facilities are unlikely to be in place to import coal at a faster rate than implied by the suggested decline in contract tonnage. But without some such arrangement mining companies might well not be interested in bidding. And the scheme would offer immediate benefits to the generating companies, compared with the 1990-1993 coal contracts. The precise way of

tapering the contracted tonnage over three years at reducing prices would have to be studied and debated. The example above is no more than an illustration, though the authors believe it to be of about the right size and shape.

### *Pensions*

British Coal administers a nationwide scheme, responsible for about 270,000 pensioners and valued at over £6,000 million. British Coal should transfer appropriate funds to a new scheme on terms agreed with actuarial advisers to the Crown Coal Commission. After privatisation, no company should be free to withdraw its employees from the scheme without their consent. Thus only if they could offer better value would employees be willing to transfer.

### *Redundancy*

*Privatise Coal* argued for more generous terms for staff losing their jobs through redundancy at the time of privatisation or within five years thereafter.

Since 1987 redundancy payments have become more generous, and the rundown of staff has been almost entirely voluntary. Fewer than 60,000 miners and only about 80,000 total staff now work in the industry. Indeed the redundancy terms are now so good that they may well give miners in some areas an incentive to want their pits to close: lump sum payments, in particular, are attractive to those who think they may soon find another job.

Whether privatisation would cause additional job losses in the near future — in an industry where uncertainty is anyway so great and morale has sunk so low — is open to question. In the long run, employment is likely to increase in a privatised, more efficient industry. Even in the short term, fewer jobs should be lost than in recent years.

An efficient privatised deep mine industry is unlikely to employ more than 30,000 miners. However, since mining employment has declined at an average rate of 20,000 per year for the last six years, to achieve a further reduction of 30,000 or so over a period of *several* years should not prove too difficult. The Government should assume responsibility, on British Coal's present terms, for all redundancies

occurring within four or five years of privatisation (including those which occur because some mines are closed rather than sold to private owners). The average payment per miner would be somewhere between £8,000 to £10,000 — amounting to £240-300 million in total. Government would thus reassure those likely to be affected, and contribute to good industrial relations. At the same time, it would make the trade sale much more attractive, leading to higher proceeds than if buyers had to assume these liabilities. So the net costs would be small

A back-up in avoiding hardship exists in the successful British Coal Enterprise Limited, founded in 1984 as a job creation agency for ex-miners, which has helped to create almost 71,000 new job opportunities in mining areas.<sup>32</sup> It should be funded to continue for five years or so after privatisation.

#### *Incentive structures*

*Privatise Coal* argued the importance of providing incentives for all employees in a privatised coal mining industry, who should have the opportunity to participate in profits and to become shareholders. Studies of share participation schemes<sup>33</sup> have shown that they affect morale and efficiency less than had been expected. Partly this may be because of their unfamiliarity, particularly in a workforce used to nationalised ownership. The authors would therefore recommend that attractive profit-based bonuses should form the main incentives — though for senior managers generous share options would, in addition, be desirable.

Privatisation should be reflected in higher living standards. Coal needs to become the high productivity, high pay industry which some of British Coal's management hoped for under nationalisation but which, because of the restraints of state ownership, it could not create. No such constraints will exist under private ownership and, with new management, the troubled labour relations of British coalmining should pass into folklore.

## 5.

# Conclusions and recommendations

The Government should use the time between now and the General Election to prepare detailed plans for a liberal form of coal privatisation. These should focus on creating a coal industry which can compete against imports, rather than an industry which needs to be protected against the outside world. In the medium to long term, such an approach will increase employment and avoid troubled labour relations. Even in the short term, the decline in employment will be modest compared with recent experience and hardship can be mitigated by guaranteeing the recently improved and generous redundancy terms.

A public flotation is not an appropriate way to sell the coal industry. A trade sale by tender to a number of buyers — probably of pits grouped in regions — is a better way to proceed. The two major electricity generators should be precluded, on grounds of competition, from bidding for coal mines, though if they are broken up any such restriction should be lifted.

Rights to exploit reserves not attributed to pits sold in the tender should be licensed by an independent body under a liberal regime designed to encourage new entrants to the industry. Existing private miners should also be encouraged by removing all restrictions on private mining in advance of privatisation: at the same time, the Government should insist that British Coal offers for sale to the private sector any pit which it contemplates closing.

There is no reason why coal should not be privatised in the ways here suggested by the end of 1993. Everyone in the industry should welcome the prospect of lifting the uncertainty which has hung over them for so many years and which has led to so much disillusionment and disaffection.

Of course, the return of a Labour government might appear to rule out coal privatisation. Yet Labour cannot be happy with the present state of the industry — from which it is most unlikely to recover under continued state ownership. Since the Party has carried out a major reappraisal of its policies, and now claims to believe that market forces are (except in cases where external costs and benefits clearly exist), the appropriate way of allocating resources, it should reconsider its opposition to coal privatisation. Evidently it does not

intend to renationalise gas, and its only explicit commitment in electricity supply is to 'take control of the National Grid'<sup>34</sup>. Would it really wish to retain coal as the only fuel industry (apart from the remnants of nuclear power) in the state sector? And would it be happy to see Soviet and East European coal mines returned to private ownership before those in Britain?

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