

Prime Minister,

23rd January, 1987

PRIVATISATION OF THE COAL AND ELECTRICITY INDUSTRIES

In order to maintain the momentum of the privatisation programme and to ensure adequate receipts during the third term of government, it will be necessary to tackle the coal and electricity industries.

The government is already under some pressure for privatising monopolies. This pressure would intensify if electricity were privatised as a single entity with inadequate guarantees for customers. It would also make privatising the Coal Board more difficult because of the CEEB's enormous buying power and the temptation for a private CEEB to buy foreign coal.

It is also important politically to consolidate the gains made in the last three years in removing some of the threat of mine workers' excessive power. It is the purpose of this paper to outline a privatisation scheme which could meet all these major objectives:

- (a) a system which was friendly to the customer and ensured competition in the supply of energy;
- (b) a system which was fair to British Coal, but did not deliver back to the NUM a monopoly power;
- (c) a privatisation which produced major receipts for the Treasury.

### British Coal

In 1985/86 the open-cast operations of the Coal Board made an operating profit of £343 million. The deep mining areas of Nottinghamshire and South Yorkshire also made operating profits, in the case of Nottinghamshire a significant £97 million contribution. The rest of the regions were loss-making, in the case of South Wales, North Yorkshire and Scotland substantially so.

The bulk of the saleable output from British Coal is purchased by the CEGB. In order to create a satisfactory coal market there is a strong argument both for creating more than one purchaser of coal - several electricity generating companies - and splitting the producers of coal into several operating groups who would compete one with another. There is

also the prospect of creating a middle way between the two in the form of separately financed new coal stations linked to particular coal supplies in a combined power generation and coal-mining company. The Northern Ireland Lignite Power Station is a partial pioneer of this approach, being a privately-financed venture linking in to the national grid.

The first task in privatising the coal industry would be to sell the Open-cast reserves in Scotland and under the Open-cast Executive. If the new owners are to be entitled to enjoy all of the profit that comes from the cheap costs of Open-cast mining compared with the favourable average price of coal, the proceeds of the sale would be substantial. If the business was unencumbered with debt the net profits of some £220 million could be sold for a capital sum well in excess of £2 billion. If the government wish to retain a royalty on the coal to reduce the profitability of open-cast mining and enjoy a continuing annual income, then the proceeds would be proportionately reduced depending on the level of royalty fixed.

The next task in privatising British Coal could be a management and employee buy-out of the Nottinghamshire and perhaps the South Midlands pits. This could be done on extremely favourable terms to the miners, although the current progress being made in restoring profitability is serving to

raise the value of these assets all the time. The government could decide either to give the miners good terms or could transfer some of the commercial debts with the Nottinghamshire mines to reduce the operating profits at the pre-tax level and so make the purchase price realistic.

Once these two sales have been achieved there would then be three competing coal producers in the country. The market should also be opened up to other investors who wished to produce coal. You could find other groups interested in sinking deep mine shafts in new coalfields using private capital, and you could also find people interested in re-entering disused NCB coal mines or processing spoil tips in order to augment coal at a realistic price. The main gain from all this activity would be to break the national average price of coal and thereby serve to lower the effective market price, enabling more to be sold against competing and often imported fuel stuffs.

The government at the same time should remove from the Coal Board the monopoly it has over licensing the extraction of coal. This should become a matter for the Department of Energy operated under a clear policy of impartiality between British Coal, the newly privatised coal businesses and the long-standing private sector interests.

## Electricity

The electricity industry is a colossus comprising both the Central Electricity Generating Board and the Area Boards under the loose framework provided by the Electricity Council. The provision of an electricity supply to every home and factory in the country is as near to a monopoly as you can get. There are those who believe that the Area Boards could be made to compete by emulating one another were they sold separately. In practice this is likely to amount to little as each Area Board will always be able to argue that the circumstances of its own area are different justifying a different performance from those of its neighbours. The only type of competition that really works is where someone else can offer an alternative supply and the costs of entry into the retail distribution market in electricity are near to prohibitive.

Conversely, the supply of power to the grid is not a monopoly at all. It is quite economic for an individual investor to buy one, two or three power stations and supply his power to the Area Boards assuming satisfactory contractual relationships can be worked out. At the moment power is supplied to the electricity grid on the basis of a merit order. The merit order is based on the accounting unit costs

of the power produced in each station, The nuclear stations provide the base load both for operational reasons because they cannot be turned on and off quickly, and because they produce quite cheap power once the costs of construction have been sunk.

This merit order system could be rejigged to produce a competitive pricing system enabling private suppliers to plug in to the national grid. A National Nuclear Corporation could own the nuclear power stations and take with them the nuclear research establishments and reprocessing plant, remaining in public hands. The rest of the power stations could be grouped into area and/or merit order groupings and sold off to private investors. An ideal system would be to have five such companies owning groups of power stations, all of them floated on the Stock Market. Their contract with the grid and Area Boards would entitle them to sell that amount of power which the system required from them. The allocation between the competing companies would be based on the price at which they were prepared to supply it. As the days got colder or as the peak hours approached, more power would be called up from the marginal producers. They could base their prices on the current merit order system of unit costs or they could, of course, decide to cut their price and reduce their margin if they were keen to run their power stations more extensively.

Privatisation of the assets of the CEGB on this basis could bring in more than £4,000 million. This is considerably below the stated current cost balance sheet value, but this is inevitable given the very high costs of replacing the plant and the relatively low margins on electricity sold. It would not be a good idea to increase the margins substantially before privatisation in order to raise the proceeds: electricity would then, indeed, be a surrogate form of tax collection and seen as such. Subsequently Area Boards could be sold, but they would need a regulatory system to control them.

#### The politics of it

The politics of the individuals involved is complicated. Robert Haslam at British Coal is not a particularly strong man but he and his senior colleagues will resist the idea of splitting British Coal into bits. The whole Coal Board is wedded to the notion of a great national utility based on years of experience as a monopolist. It was this that made your task in winning the miners' dispute so difficult and makes the task of splitting it even more vital.

There will be those who worry about NUM reactions. My own view is that the NUM is not going to recover major power within the next three years and this should be done at the

The bitter  
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of the  
pre 1948  
private  
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is also  
still a  
factor.

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beginning of the next term of government whilst the government is still riding high. High stocks and a Spring announcement will also give protection.

The politics of the CEGB are even more complicated. Lord Marshall is an extremely powerful character who wishes to privatise the electricity industry whole. He might accept the idea of running a National Nuclear Corporation in the public sector if, at the same time he had influence over the number of new nuclear power stations that were going to be built. These could be factored in to the system of a privatised CEGB, as all nuclear stations would be base-load and the private investors would have to be aware of the size of the nuclear programme which the government was going to carry out.

### Conclusion

It would be a pity to let individual personalities ruin a major privatisation opportunity. It is vital that competition is the cornerstone of a privatised electricity and coal industry. Splitting the CEGB and selling the open-cast and successful mining areas would create the right degree of competition and raise substantial proceeds for the government.

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