

The Decline of U.K. Coal: Economics or Politics?

By Michael J. Parker*

The decline of the U.K. coal industry under Conservative Governments since 1979 has often been characterized either as a political conspiracy against the National Union of Mineworkers (NUM), or as the inevitable outcome of "market forces." In fact, the process has been the result of the complex interaction of political and economic factors.

The Political Agenda on Coal

The evidence for a *political agenda* on coal is clear. The Government's attitude can be illustrated from the memoirs of some of the key players. Following the Government's temporary climb down on colliery closures in February 1981, Nigel Lawson wrote: "Our original aim was to build a successful, profitable coal industry independent of government subsidies, to de-monopolize it and ultimately open it to private enterprise... Then the events of February 1981 showed beyond any reasonable doubt we will make no progress towards our aim until we deal with the problem of monopoly union power."¹ And on the 1984/85 NUM strike, he wrote, "Just as the victory in the Falklands war exorcised the humiliation of Suez, so the eventual defeat of the NUM etched in the public mind the end of militant trade unionism which had wrecked the economy and twice played a major part in driving elected governments from office."²

On his pledge in 1988 to achieve the "ultimate privatization" of coal, Cecil Parkinson wrote: "What was ultimate about the proposed privatization of coal was that it would mark the end of the political power of the National Union of Mineworkers."³ He added: "I have never understood the argument that Britain somehow owes a great debt to the mining industry. The industry was given privileged position and it abused the privilege."⁴

The views in Margaret Thatcher's memoirs were, if anything, even more robust. She wrote: "By the 1970s the coal mining industry had come to symbolize everything that was wrong with Britain."⁵ "It was crucial for the future of the industry and the country itself that the NUM's claim that uneconomic pits should never be closed should be defeated...and the use of strikes for political purposes discredited once and for all,"⁶ and "What the strike's defeat established was that Britain could not be made ungovernable by the Fascist Left."⁷ Privatization of British Coal was seen as vital, as privatization in general "was one of the central means of reversing the corrosive and corrupting effects of socialism."⁸ Thus, the *political agenda*, established early in the Thatcher years, consisted of two main elements. First, to eliminate the ability of the NUM "to hold the country to ransom," thereby providing the keystone of a policy to reduce what was seen as the unacceptable power of the trades unions. Second, to subject British Coal (BC) to market forces, in order to change it from the archetypal nationalized industry dependent on state funds into a profitable business which could (ultimately) be denationalized, thus discrediting socialist nationalization. Both these elements of the *political agenda* reinforced each other.

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¹ See footnotes at end of text.

The Economic Fundamentals

In the period between the defeat of the NUM strike in 1985, and the major "downsizing" of the coal industry that occurred after the resolution of the "coal crisis" of October 1992, British coal remained over 80 percent dependent on sales to power stations (and provided over 60 percent of the total fuel used for power generation). In itself, this was not unusual for a steam coal industry (the U.K. industry produced little coking coal). The problem was that the costs of deep mines (which in 1985/86 made up 85 percent of British Coal output) were generally uneconomic against the price of internationally-traded steam coal. Over the period 1986/87 to 1991/92, average U.K. colliery operating costs were higher than the delivered price of imported coal by about £12/tonne at inland power stations and about £22/tonne at coastal stations.⁹ For the overall average cost to be competitive would have required cost reductions of about a quarter over and above the significant cost savings actually achieved in this period, but given the distribution of costs and delivered prices around the average, this would still have left about half of deep-mined output uneconomic. Moreover, imported coal usually had lower sulfur and chlorine contents than U.K. coal. Although there were clear limits to the amount of coal that could be imported, particularly in large vessels, the post-strike position was not sustainable in the long run, except in the absence of an improbable large increase in the delivered price of imported coal. Yet any attempt to implement a policy of "convergence" between U.K. deep-mined costs and imported prices would necessarily involve substantial reductions in manpower, either through the closure of irredeemably uneconomic collieries, or through the necessary increases in productivity at continuing collieries, or both. Thus, a policy to reduce the industry to its "economic size" (that is, consisting only of collieries and opencast sites capable of operating profitably without either subsidy or cross-subsidy) was entirely consistent with the *political agenda* of reducing the power of the NUM by reducing the number of mineworkers.

Further, such a policy was likely to prove to be irreversible because of the rapid erosion of the coal reserves base available to the U.K. industry. Effectively, a deep mine, once closed, was unlikely to be re-opened, and its reserves lost except in some cases adjacent to continuing mines ("Mothballing" capacity was prohibitively expensive except as a temporary and limited expedient). Moreover, the drive to reduce costs has meant ever more selective working of accessible reserves to exclude seams/districts not capable of yielding high productivity. This tendency has been reinforced by the capital intensity of the most modern coalface equipment, which requires high utilization. In addition, it became clear that, with the end of the era of high fossil fuel prices following the collapse of oil prices in 1986, and the continuing expansion of world trade in steam coal at low prices, it was very improbable that major new deep-mines would be sunk in the U.K. (once the "Plan for Coal" program was completed), as capital charges would overwhelm any reduction in operating costs. Thus, in effect, the coal reserve base was limited to seams currently accessible without major expenditure at those existing deep mines which were able to

(continued on page 6)

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The Decline of U.K. Coal (continued from page 4)

survive in the short-term, together with opencast coal in such sites as were able to secure planning permission in the face of environmental opposition.

One of the effects of the coal crisis of October 1992 (when British Coal announced the rapid closure of 31 of its 50 deep mines) was that the Government's subsequent Coal Review for the first time brought a realistic assessment of coal reserves into the public domain. By the time BC's mining assets were sold off at the end of 1994, a reasonable assessment of remaining accessible reserves for deep mines was little more than 600 m. tonnes – a reserve/production ratio of about 15:1. Given the unequal distribution of reserves between pits, and the absence of significant replacement capacity, a further fall in deep-mined output can be expected over the next 10/15 years.

Increase in Environmental Concerns

The 1980s saw a steady and significant increase in environmental concerns relating to coal and a change in their character – with increasing emphasis on atmospheric pollution and global warming. The implementation of the EC's Large Combustion Plant Directive from 1988 committed the U.K. to progressive and substantial reductions in SO₂ emissions – down to 40 percent of 1980 levels by 2003 at existing power stations. This was seen as a growing threat to U.K. coal (average 1.6 percent sulfur as against 1 percent or less for imports), particularly as the retro-fitting of Flue Gas Desulphurization (FGD) plant was to be confined to only 6GW of coal-fired plant. From 1988 onwards, coal-fired power stations were often portrayed as the main danger to the planet. As Mrs. Thatcher wrote: "Coal-fired power stations pour out carbon dioxide into the atmosphere and no-one has yet put a credible figure on what it will ultimately cost to deal with the resulting problem of global warming."¹⁰ Indeed the Government lost no opportunity to stress the environmental disadvantages of coal.

The Achievement of the Government's Policy Objectives for Coal

By 1995, the Government's policy objectives for coal (as set out in the political agenda above) had effectively been achieved, summarized as follows:

	1979/80	1995 est.
Deep mine output (m.t.)	109	32
Number of mineworkers (000)	232	8
U.K. coal as % of total power station fuel	76%	30%

Further, with the sale of BC's mining assets, the industry was privatized in December 1994. The NUM's ability to disrupt electricity supplies has been greatly reduced, and its political power effectively ended.

The Government's success in meeting its policy objectives derives from a number of factors:

1. The policy was pursued consistently over a long period. Of course, this depended on holding political office with working majorities. If general elections had had different results, the outcome for the coal industry would have been

very different.

2. The economic fundamentals of the industry, and the generally plentiful supplies of fossil fuels at falling real prices from 1986, reinforced the *political agenda*; and rising environmental concerns, while not decisive in themselves, provided further weight and public justification for the underlying policy. Policy went "with the grain of events."
3. The coal industry had no political constituency of any real influence at national level. Its support was concentrated in Labor-controlled areas, and parliamentary advocacy by NUM-sponsored MP's was counter-productive. (In this respect, there was an enormous difference from Germany, where the Federal structure has enabled the coal industry to retain strong political influence).
4. The Government had the luck of having Arthur Scargill as an opponent in the 1984/85 strike, which led to the creation of the break-away UDM. Without continued working of the UDM pits, it is doubtful if the strike could have been defeated. And if the strike had not been defeated, the Government could not have achieved its objectives.

But in addition to these factors, the attainment of the Government's objectives owes much to the operation of:

- (a) The privatization of the Electricity Supply Industry (ESI).
- (b) Measures to promote coal industry restructuring through subsidy.

We consider these in turn.

Privatization of the ESI

The decision to privatize the ESI before the coal industry had considerable advantages for the Government in relation to coal policy. Firstly, because the ESI privatization process would itself be complex and protracted, this would allow more time for British Coal to close collieries and rundown manpower in a more orderly fashion over a longer period. Secondly, any subsequent restructuring of the coal industry prior to its own privatization could be characterized as the result of commercial decisions by private electricity companies, rather than action by Government. ESI privatization would unleash powerful forces to downsize the coal industry by remote control. Indeed, as Mrs. Thatcher says in her memoirs, "...a privately owned electricity industry would be much more demanding in the commercial terms it expected from the NCB (i.e., British Coal) than would a state owned monopoly."¹¹

Yet, in the initial ESI privatization settlement in 1989/90, the Government was concerned not to prejudice its coal policy. It would appear that the Government acted on three principles.

Firstly, BC needed coal contracts with the major generators sufficiently favorable to BC to avoid the Government having to deal with a "second front" on coal until the ESI had been safely transferred to the private sector. Further, the coal contracts would have to provide for sufficient volumes of coal sales to power stations to avoid large-scale colliery closures which could be attributed directly to ESI privatization; and for coal prices which, although declining in real terms, would be compatible with BC's progress

towards acceptable levels of profitability without explicit subsidy. The *coal subsidy* (the difference between BC prices and hypothetical free market prices based on parity with imports) should continue to be hidden in the coal price.

Secondly, the coal contracts had to be of sufficient duration and firmness to preclude any reopening until after the next General Election (due by 1992), and to allow any subsequent radical "downsizing" of the coal industry to be presented as the result of market forces rather than Government policy. On the other hand, it was already clear that further substantial contraction of the coal industry would be required before BC could be privatized. Thus although the new coal contracts needed to be sufficiently favorable to BC to avoid a contentious quantum of closures in the short term, they could not be of a duration so long as to preclude the downsizing of the coal industry in time to privatize BC within the terms of the following Parliament. Such considerations suggested a contract duration of about three years.

Thirdly, the coal contracts were needed to provide an element of price stability to electricity consumers in the period immediately following ESI privatization. The coal contracts had to be "back-to-backed" into the Regional Electricity Companies' (RECs) franchise markets under a framework of "contracts for differences," and coal prices had to fall in "real" terms in order to increase the profitability of the ESI while maintaining franchise (i.e., domestic) prices broadly constant in "real" terms.

The contracts which emerged were a skillful Government-imposed reconciliation of the policies towards the ESI and the coal industry, with BC sales falling a relatively modest 10m tonnes over three years, and prices by an achievable 5 percent p.a. in "real" terms. However, this was a temporary government "fix" which postponed the difficult decisions till later.

At the time of ESI privatization, it was widely expected that in the future the main challenge to BC would come from increased coal imports by the two main generators: 30 m. tonnes was a widely quoted figure. However, this did not materialize. The main impact on U.K. coal came from a large and rapid program of gas-fired combined cycle plant (CCGTs), known popularly as "the dash for gas." In large measure this arose from the policy of promoting competition in generation by reducing the dominant market share of the duopoly of National Power (NP) and PowerGen (PG) whose plant was mainly coal-fired. Given that, initially, divestment of plant by NP and PG was not contemplated, the only way to reduce their market share was to build new generating plant not owned by NP or PG. In turn, the most cost-effective new stations were CCGTs, which RECs proceeded to build in association with oil companies with surplus gas, with long-term contracts both for supply of gas and the sale of the electricity at high load factors. NP and PG also responded with their own CCGTs in order to protect their market share in the longer term. The net effect of the "dash for gas" was that by the mid-1990s some 30 m. tonnes of BC's sales to the ESI would be lost to gas (even though the avoidable costs of the coal-fired stations, using BC coal, were in many cases less than the total costs of the new CCGTs).

Finally, NP and PG made it clear that, once the initial three-year coal contracts expired in 1993, they would be free

to reduce their stocks of coal, which exceeded their commercial requirements by over 20 m. tonnes.

Thus, during 1992 it became clear that any subsequent coal contracts would involve a drastic reduction in BC's coal sales. Although the means by which these reductions had been secured were not wholly intended, the result was compatible with the Government's policy of downsizing the coal industry to an economic core which would be saleable to trade buyers. Given the risks, there was no way in which buyers would be found unless the major restructuring was done prior to coal privatization. But further firm coal contracts from 1993 were also essential to the sale of BC. Although the "coal crisis" of October 1992 caused some temporary rephrasing of closures, the end result was the same. BC contract sales to NP and PG fell from 65 m. tonnes in 1992/93 to 40 m. tonnes in 1993/94 and 30 m. tonnes for the next four years, at prices initially well above import parity, but falling in "real" terms over the five years. These contracts would not have been secured without the intervention of Government, or the agreement of the Regulator that the higher costs involved could be passed through by the RECs into the franchise market.

Measures to Promote Coal Industry Restructuring Through Subsidy

We have already seen that the price and volume of BC coal sales to generators had been supported by Government-brokered contract arrangements both before and after ESI privatization at levels which would not have obtained in "free market" conditions. Although there was no overt subsidy, and no public expenditure was involved, these contracts were an essential element of government support on a progressively "tapering" basis, as a means of securing a politically acceptable phasing of decline. If BC deep-mined output over the ten years 1985/86 to 1994/95 had been priced on an "import parity" basis, then an overt subsidy of some £11 billion at 1995 money values would have been required to sustain production.

But other measures of restructuring was funded by the taxpayer, rather than the electricity consumer. Government funded a very generous redundancy scheme and the other "social" costs associated with the rundown of manpower. These arrangements were so organized that BC was not inhibited in any way from running down manpower by the cost of doing so, and the redundancy payments were so pitched as to allow a policy of voluntary redundancy to be sustained, thereby making any union opposition to closures ineffective, either at the national or local level. The amounts involved were very large. Government expenditure on redundancy payments and other social costs, over the ten years 1985/86 to 1994/95, amounted to some £10 billion at 1995 money values - approaching £50,000 per job lost. This is a measure of the importance the Government attached to the achievement of its coal policy objectives. There appears to have been no attempt to weigh the costs of restructuring and redundancy against the wider social or unemployment costs. The rapid rundown of coal industry manpower was financed by Government in a way which effectively precluded an overall calculus.

(continued on page 8)

The Decline of U.K. Coal (continued from page 7)

Conclusion

There is no doubt that there has been a *political agenda* for coal, the objectives of which have effectively been achieved, as a result of a variety of factors, including the fact that policy went "with the grain" of market forces.

Given the objective of a competitive industry, substantial reductions in deep-mined output and, even more so, in collier manpower, were inevitable. But the reduction might not have been so rapid if the "dash for gas" and the generators' stock lift has been moderated. On the other hand, unmitigated free market forces would have led to precipitate and chaotic collapse.

The whole process was less one of free markets than of Government management to secure politically acceptable phasing. Whether the scale of the transitional cost to the electricity consumer and the taxpayer were justified will need to be the subject of a further study!

References

¹ N. Lawson: *The View from Number 11* (London: Bantam press 1992) p. 142.

² Ibid. p. 161.

³ C. Parkinson: *Right at the Centre* (London: Weidenfeld and Nicolson 1992) p. 280.

⁴ Ibid. p. 281.

⁵ M. Thatcher: *The Downing Street Years* (London: Harper Collins 1993) p. 340.

⁶ Ibid. p. 364.

⁷ Ibid. p. 378.

⁸ Ibid. p. 676.

⁹ For calculations see: M.J. Parker: *The UK Coal Crisis: Origins and Resolution*, (Chatham House 1993).

¹⁰ Op.cit. p. 684.

¹¹ Op.cit. pp. 685.

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