I circulate, for the information of my colleagues, the attached Memorandum by the Coal Controller.

The points requiring Cabinet decision are

(1) The date from which the owners are to be charged with the increased wages.

(2) The date from which an amended Agreement or new Act is to become operative.

(3) Whether the profits of Coke Ovens and Bye Product Plants are to be included.

(4) Whether any allowance is to be made for additional capital expended on the mines since 1913.

A. C. Geddes.

15th April, 1919.
Memorandum on the interpretation of the Interim Report and on the arrangements necessary to give effect to its recommendations as regards the limitation of the profits of the Coal Owners.

The Interim Sankey Report provides:

1. That wages are to be increased by 2/- per day for men and 1/- per day for boys, which is equal to about £30,000,000 per annum.

2. That from July 16th next 7 hours is to be substituted for 8 hours as the day's work, making a reduction of 12½%, which is estimated to reduce the output by 10%, this being equivalent to a reduction of profits by £13,000,000 for 6 months, on an output of 250,000,000 tons per annum, or at the rate of £26,000,000 per annum if the reduction in output continues.

3. That in order partly to meet the increased cost, the profits to be retained by owners are to be limited to an average of 1½d. per ton of coal raised, which on an output of 250,000,000 tons is approximately £15,000,000. It is estimated in the Report that the surplus profits over the Sankey standard, if the rate of profit for the September quarter of 1918 continues for the year 1919, will provide £30,000,000 towards the increased cost. It should be noted that the greater part of the surplus profits would under the present Finance Acts be collected by the State in Excess Profits Duty and would therefore to that extent not be paid by the Owners but by the State.

The effect of the adoption of the Sankey Report on the cost to the State is shown in the Appendix to this memorandum.

In order to carry the recommendations of the report into effect the present Coal Mines Control Agreement and Confirmation Act, 1918, will have to be amended or a new Enactment Bill passed through Parliament.

It is agreed that the Average Rate of 1½d. per ton is to be distributed among individual undertakings by reducing their pre-war standards in the same proportion that £15,000,000 bears to the aggregate Pre-war Profits Standard of the whole industry. The details of the method of distribution and its adjustments are now being discussed with the Owners and are not likely to lead to difficulty.
The Report itself does not give any definition of "Profits", nor does it state what the 14d. includes. It is held by Mr. Justice Bankey to include the profits of Coke Ovens and By-Product Plants, which are excluded from the present Coal Mines Agreement, and also to include interest on Loan Capital, and remuneration for Capital expenditure on the Mines themselves incurred since 1913 or previously.

The following important questions arise for decision:

(1) The date from which the Owners are to be charged with the increased wage. It is clearly understood that as far as the men are concerned it is to be paid from January 9th last.

(2) The date from which the amended Agreement or Enacting Bill, whichever may be adopted, imposing the new limitation of profits and the consequential alterations is to become operative.

(3) Whether the Profits of Coke Ovens and By-Product Plants are to be included in the new standard of 14d. per ton of coal raised.

(4) Whether any allowance is to be made for additional Capital expended on the Mines since 1913. The 14d. is based on the average profits of the 5 pre-war years.

It is contended by the Owners:

(a) That although it was understood, so far as the men were concerned, that any increased wage awarded was to date back to January 9th, they were no party to this Agreement, and were not consulted.

(b) That although the Coal Controller can order any increase of wage to be paid and charged against expense it has not hitherto been done without a compensating increase in the price of coal nor has it been done retrospectively for more than a few weeks.

(c) That the Government must themselves pay this money both for the arrears and future payments and get it back through the operations of the Coal Mines Agreement, so far as there are profits available.

It has been arranged with the Coal Owners that the Government will provisionally advance the money without prejudice as to who is to be liable for its eventual payment.
The questions to be settled therefore are:

(a) Are the Government or the Owners to be liable for its eventual payment as from January 9th last until such date as is imposed or agreed upon for the determination of the present agreement?

(b) Are the Government to continue paying this money weekly in future as required and to treat it as an advance to be recovered out of any profits in excess of the Standard, or

(c) Will the Government fix a date after which the Owners themselves must find the money and charge it as an expense of the business?

It should be clearly understood that from the date at which the new Standard becomes operative it is immaterial whether the additional wage is payable by the Government or by the Owners. The Owners would, in either case, retain in the aggregate 14d per ton of output.

It is likely, therefore, that if they were relieved of the liability for the extra wage until the new agreement or act comes into force they would accept the liability from that time onwards.

(2) The date from which the new agreement or act is to come into force.

Under the present agreement the Owners are entitled to the profits of the Finance (No. 2) Act, 1915. Under the Sankey Report this Standard will have to be reduced to the equivalent of the 14d. per ton on the actual output, both being adjusted in accordance with the provisions of the agreement regulating the guaranteed Standards.

The Owners contend that they are entitled to the benefits of the present agreement until it is terminated by notice.

The agreement provides that after a certain date (which has been passed) it can be terminated by the Controller of Coal Mines at any time without notice.

The date of termination cannot be made retrospective except by agreement or by Act of Parliament.

It is suggested that it would be inequitable to make the agreement retrospective to the 1st January, the Sankey Report being accepted by the Miners only on April 16th, unless an allowance be made to the Owners for the period from the 1st January to the 16th April of the difference between the Sankey Standard and the guaranteed standard under the Coal Mines Control agreement. If this be conceded it is believed that the Owners would agree to continue to operate the mines under an amended agreement, pending the decision of the Government on the larger question of nationalisation and control after the Second Report of the Sankey Commission.
In considering this important question it must be borne in mind that at present the Government take all the profits over the Finance Acts Standard (subject to an allowance of £2 10s. for additional capital employed in excess of that employed in the standard period), except 25% of the excess, and that by fixing the date of the application of the new Standard as 15th April, instead of making it retrospective to the 1st January, they would only suffer to the extent, approximately, of the difference between the two Standards for 3½ months; which would be equal to about £8,000,000.

Whether the Profits of Coke Ovens and Bye Product Plants, which are part of a colliery undertaking, are to be included in the 14d. per ton.

(a) The Coal Industry Commission Act brings within the terms of reference of the Commission not only the Coal Industry but any industry commonly carried on in connection therewith, or as ancillary or incidental thereto. Mr. Shortt stated in the House of Commons in the Committee Stage of the Coal Industry Commission Bill as follows: "The intention is that in addition to enquiring into the coaling operations of the industry the Commission should also be able to go into the question of coke ovens and any other bye-products ancillary to the Coal industry."

The average 5 year pre-war profits of 1/- per ton upon which Mr. Justice Sankey based his standard of 14d. include the profits of such Coke Ovens and Bye-Product Plants as were in operation, but they were not included in the estimated profits of £54,000,000 upon which he based his calculations as to the deficiency.

This question has been fully discussed between Mr. Justice Sankey, Sir Robert Horne and Sir Ivan Jones. Mr. Justice Sankey states that he meant the Profits of those Coke Ovens and Bye-Product Plants which are under the same ownership as the Coal Lines to be included as part of the profits of coal raised, but that this would not apply to those Plants which, although they may be situated at the Colliery, would not be under the same ownership. He agrees, however, it would be just that an allowance should be made for interest on Capital expended since 1913, or expended previously, but which had not become productive until after 1913, on Coke Ovens and Bye-Product Plants, as an addition to the Standard Rate of 14d per ton or its equivalent as the case may be.

The following points should be taken into consideration:

(a) Coke Ovens and Bye-Product Plants are dealt with as a distinct and separate industry and are separately assessed by the Inland Revenue both for the purpose of Income Tax and Excess Profits Duty.

(b) The Report states that the average standard Profit of 14d. per ton of coal raised and it is not supposed to include the profits of coke ovens and bye-product plants.

(c) The Coal Industry Commission Act brings within the terms of reference of the Commission not only the Coal Industry but any industry commonly carried on in connection therewith, or as ancillary or incidental thereto. Mr. Shortt stated in the House of Commons in the Committee Stage of the Coal Industry Commission Bill as follows: "The intention is that in addition to enquiring into the coaling operations of the industry the Commission should also be able to go into the question of coke ovens and any other bye-products ancillary to the Coal industry."

The average 5 year pre-war profits of 1/- per ton upon which Mr. Justice Sankey based his standard of 14d. include the profits of such Coke Ovens and Bye-Product Plants as were in operation, but they were not included in the estimated profits of £54,000,000 upon which he based his calculations as to the deficiency.

This question has been fully discussed between Mr. Justice Sankey, Sir Robert Horne and Sir Ivan Jones. Mr. Justice Sankey states that he meant the Profits of those Coke Ovens and Bye-Product Plants which are under the same ownership as the Coal Lines to be included as part of the profits of coal raised, but that this would not apply to those Plants which, although they may be situated at the Colliery, would not be under the same ownership. He agrees, however, it would be just that an allowance should be made for interest on Capital expended since 1913, or expended previously, but which had not become productive until after 1913, on Coke Ovens and Bye-Product Plants, as an addition to the Standard Rate of 14d per ton or its equivalent as the case may be.

The following points should be taken into consideration:

(a) Coke Ovens and Bye-Product Plants are dealt with as a distinct and separate industry and are separately assessed by the Inland Revenue both for the purpose of Income Tax and Excess Profits Duty.

(b) The Report states that the average standard Profit of 14d. per ton of coal raised and it is not supposed to include the profits of coke ovens and bye-product plants.
(c) The Collieries having Coke Ovens would therefore have little inducement to continue to work them, as they would still be entitled to approximately the same standard profit per ton of coal raised if they stopped their Coke Ovens.

(d) The great development of Coke Oven and Bye-product Plants during the War was primarily due to the urgent war necessity for these products, and their erection and development were actively encouraged by the Government and controlled in the interests of the Nation. Their post-war development is equally important.

(e) The Coke Ovens are expressly excluded from the Coal Mines Control Agreement (Confirmation) Act.

(f) Although the profits of the Coke Ovens for the 5 pre-war years' average were included in the 1/- per ton average profit of coal raised, they amounted only to about 1½d per ton; whereas in 1918 on the same output of coal they represented about 6½d per ton of coal raised, which would be included in the profits limited to 1½d per ton.

(g) The Coal Owners strongly protest against their inclusion, and definitely state it will kill the industry as far as they are concerned. They lay special stress on the fact that they are definitely excluded from the Coal Mines Control Agreement by a clause in the Act, and point out that the Capital invested in the Coke Ovens is in the case of some Collieries as much, if not more than, that invested in the mines; and further, that only a small proportion of the total number of Collieries have Coke Ovens, and that in consequence a very invidious distinction will be drawn against those Owners who had erected Coke Oven Plants.

If it is determined that the Coke Ovens and Bye-Products Plants are to be included under the new Agreement the amount of interest to be allowed in consideration of the expenditure of additional capital since 1913, requires to be determined. Under the Finance Act, 1918 the rate allowed for excess Profits Duty purposes is 6%.

4. Whether any allowance is to be made for additional Capital expended since 1913.

It is claimed by the owners that interest should be allowed on capital not employed in excess of that employed in the pre-war period.

In so far as the capital has increased the earning capacity of the undertaking the Coal Mines Control Agreement provides for it to be rewarded. Moreover, in fixing 1½d as the Standard of profit as compared with the pre-war average of 1/-, Mr. Justice Conroy has taken into account the increase in the capital employed in the mines.
It should be pointed out that capital invested in development should lead to increased output and so to an increase in the aggregate of the standards provided for by Mr. Justice Sankey, but the owners contend that the Sankey Standard of Profits is not sufficient to render the introduction of further capital remunerative, either for the purpose of maintaining the existing output of mines or for new developments.

As a matter of fact the Sankey Report is already having a marked effect in arresting development.

In regard to the General question of the sufficiency of the standard of 14d per ton of coal raised, as recommended by the Sankey Report, it is pointed out by the Owners that the present reduced value of money as compared with the pre-war value has not been taken into account and that the value of 14d today consequently bears no relation to the value of 14d before the war.

To place the owners on the same basis of profit in relation to the purchasing powers of money as in the pre-war years it would be necessary to allow 2//- today for every 1/- in 1913.

Evan D. Jones.

Controller of Coal Mines,
15.4.19.
Appendix.

Sankey Interim Report.

The Cost to the State.

The Sankey Report estimates £54,000,000 as the profit of the Coal Industry for 1919.

This figure is arrived at as follows:

The profits for the quarter ending 30th September, 1916, were estimated as equal to 3/7d. per ton on the actual output of the whole industry.

It was assumed that for the year 1919 the output would be increased to 264,000,000 tons which would have the effect of reducing the cost per ton and therefore increasing the profit per ton by 6d.

It was therefore estimated that, assuming the average selling price of coal (including exported coal) was maintained, the profit of the whole industry for the year 1919 would be 264,000,000 x (3/7d. + 6d.) 4/1 = £54,000,000.

The 4/1d. per ton is exclusive of the profits of Coke Ovens and Bye Product Plants, but inclusive of the interest on Loan Capital.

From the £54,000,000 thus arrived at the Sankey Report deducts £9,000,000, equal to an average profit of 6d per ton over the whole output, for the probable falling off in the profits on Coal exported, which might be due either to a reduction in the quantity exported or to a fall in the price or to both; thus bringing the total estimated profits for 1919 down to £45,000,000 - out of which it allows £15,000,000 to be retained by the Owners, leaving £30,000,000 as available towards the cost of the increased wage and reduced hours, which the report estimates at £43,000,000.

This estimate of £43,000,000 is made up of £30,000,000 for increased wage for one year and £13,000,000 for increased cost for six months due to reduced output following the reduction in hours.

It has been estimated that a reduction of 12½% in the working hours will result in a reduction of 10% in the output which would increase costs and reduce the profits by about £13,000,000 for 6 months.
As the shortened hours do not come into operation until July - the report estimates as the cost for this year (i.e. up to Dec. 31st. 1919):-

- Increase of wages for 1 year — 230,000,000.
- Loss of output for six months — 133,000,000.
- Loss of output for six months — 283,000,000.
- Less amount to be recovered by limiting profits — 230,000,000.
- Deficiency — 13,000,000.

It must be carefully noted that this is on the assumption that the abnormal profits made in the third quarter of 1918 will be maintained, less the 8d per ton allowed for a falling off in the profits of the Export Trade.

The Sankey Report speculates (p.11) on a decrease in the estimated reduction of output, and on savings by economies in production, etc. As regards the first, although in course of time some decrease may be looked for, it is not safe to make any allowance on this account in present calculations. As regards the second, the limitation of Profits to a fixed rate per ton while it provides an incentive to increased output, gives no inducement to economy in working. Since Owners can be sure of their equivalent of 14d. per ton profit, even with antiquated methods, and can in no case retain more, the cost of production becomes immaterial, and there is nothing to induce them to expend further Capital on improved methods or even to check extravagance or waste. Further the same effect will be produced in commercial transactions. The price to be obtained for the coal will be immaterial to the seller.

In order to arrive at the cost to the State which will be involved in the maintenance of the new guaranteed standard, after providing for the cost of the increased wages and decreased output, the figures for one whole year will be as follows, assuming the price to the home consumer is not raised:—

Profit assumed by Sankey Report ——— 255,000,000

Deduct — Increase in wages (1 year) — 30,000,000

Decrease in output (1 year) — 256,000,000

Loss — 11,000,000.

Owners Guaranteed Standard ——— 15,000,000.

Total deficiency ——— 26,000,000.
The amount which should be provided in the estimate for 1919-20 will depend on the decision as to the date when the new Sankey Standard of Profit is to come into operation. Assuming this date is made retrospective to 1st January so as to coincide approximately with the payment of the increased wages, the amount should be:

**Increased wages** - 9th Jan: 1919 to 31st Dec: 1919 £30,000,000

" " 1st Jan: 1920 to 31st Mar: 1920 £7,500,000

**Decrease in Output** - 1st July 1919 to 31st Dec: 1919 £13,000,000

" " " - 1st Jan: 1920 to 31st Mar: 1920 £6,500,000

Estimated Profits on basis of September quarter of 1918, for year to 31st Dec, 1919 - £245,000,000

Do. on first three months for 1920 £11,250,000

Less Owners Guaranteed Standard for 1½ years £18,750,000 37,500,000

Amount required to meet deficiency £19,500,000

If on the other hand it is decided that the Sankey Standard shall not be applied to the owners until some subsequent date, then for every month it is so deferred approximately £1,000,000 must be added to the Estimate.

These estimates are on the assumption that the assumed Sankey Profit at the rate of £45,000,000 per annum will be realised and they are subject to increase or decrease in proportion to any variation in this assumed profit.

The cost to the State should be regarded from the point of view that the lack of incentive to economy will be cumulative in its effect, and it is not reasonable to expect that the profits will be maintained at the level of 1918. On the contrary, it should be considered that the maximum profits to be retained by the Owners will become the maximum profits of the industry, even if they would be maintained at that level.

Evan D. Jones.