

ECONOMIC RECONSTRUCTION GROUP

The next meeting will be held on Friday 8th July 1977
at 11.00 a.m. in the new Westminster Hall Interview
Rooms at the House of Commons, Room W.1.

AGENDA

To discuss the Final Report of the Nationalised Industry
Policy Group chaired by the Hon. Nicholas Ridley.

Paper enclosed: Nationalised Industries Policy Group
Report (PG/10/77/38).

Anne Bulloch

AB/LSA

30th June 1977

The Conservative Research Department
24 Old Queen Street
London SW1

ECONOMIC RECONSTRUCTION GROUP

8TH JULY, 1977

Final Report of the Nationalised Industries Policy Group

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FINAL REPORT OF THE POLICY GROUP ON THE NATIONALISED INDUSTRIES

PART 1 - Running Nationalised Industries

A. MOTIVATION

1. There are fundamental differences between the private and the public sector. In the private sector there is the fear of bankruptcy and redundancy - "the stick"; there is also the hope of reward in the form of higher dividends, salaries or wages, as the results of success - the "carrot".
2. These "sticks" and "carrots" are weaker in the nationalised industries. The sanction of bankruptcy does not, and cannot apply although that of redundancy can and does. The incentive of working for higher reward applies in relation to piece-work or payment-by-result schemes - in no cases does it apply to management, let alone to the providers of investment capital. People are rarely dismissed for inefficiency.
3. There is a need to provide sticks, and carrots, in the public sector. They are bound to be infinitely less effective than those in the private sector - because of the very nature of the public sector and its immunity from bankruptcy. But some sanction is necessary when there is a serious failure - and some reward is necessary when performance is good.
4. One element of our policy for the public sector should be to provide greater rewards for success and penalties for failure - particularly for managers - but as far as is practical for all concerned.
5. More and more the nationalised industries are run for the benefit of those who work in them. The pressures are for more jobs for the boys, and more money for each boy. The need to satisfy the customer is less and less apparent: mainly because they tend to be monopolistic concerns.
6. Another element of our policy should be to break up the monopolies, and to make each unit of public industry survive, and prosper, by means of providing a better service to the public than its competitor. There are sections later in this paper describing how we should do this.

B. MANAGEMENT INFORMATION

1. Unit costs are vital information in relation to measuring efficiency. Any attempt to improve efficiency must start from considering unit costs. In the nationalised industries the output is measurable and unit costs can be obtained.
2. The strange thing is that this information about unit costs is not made available publicly, although it is probably available to managers in the nationalised industries. This information would be of the greatest value in monitoring efficiency. Parliamentary Questions asking for information about the unit costs of nationalised industries and the comparable costs in other industrialised countries are answered by Ministers by saying that the information is not available. It is clear from answers that the civil service either does not know or will not release such information.
3. The truth is that the Government's attitude to the public sector is not commercially orientated. The cost of producing steel, or electricity, or coal, or air travel is determined by a mixture of the political pressures and the union pressures. The income that may be obtained depends upon what the customers will pay, and the political pressures at work. The resulting return on capital varies between zero in the Steel Industry, to a 120% return on capital in the duty free shops at London Airport, but it is usually much less than the cost to the State of providing the capital.
4. The cost and the income are not related in the bureaucratic mind. It follows that the loss is a residual representing the political price that must be paid. Striving after efficiency has thus tended to be fruitless - because both the financial inputs and the financial outputs are the result of political determination. Publishing unit costs would at least highlight the extent of the inefficiency.
5. The nationalised industries should be required to keep and to publish detailed unit costs, in the interests of public accountability.

C. COMPETITION

1. The public sector is very seldom found in successful direct competition with private producers. There are exceptions - buses, some ports, special steels, Giro, parts of the National Freight Corporation and a few others. Such competition nearly always results

in heavy public sector losses, rather than in an attempt being made by the public sector enterprise to improve its performance. The usual reaction is to seek ways of disguising the loss, and/or of disadvantaging the private sector competitor, or better still obliterating it. For instance the National Bus Company sought to dress up its 1975 loss of £19m as a profit of £1m in its accounts - the Giro behaved similarly. The B.T.D.B.'s answer to Felixstowe's success was to try to buy it out; the BSC's reaction to competition in special steels was to put up the price of crude steel to its competitors discriminately. None of them sought to increase efficiency in order to meet the competition.

2. The sanction of competition for the public sector therefore, although in theory desirable, is not really effective so long as no penalty attends upon losing in that competition. Losses have always been made up in the past. Special pleading as to how they arose has always been accepted. No disciplinary action has ever resulted.

3. There is another respect in which such competition is unfair. Private companies have to raise capital in the market at commercial rates, whereas the Nationalised Industries can borrow from the Exchequer easily and relatively cheaply.

4. It follows that competition between private and public sector companies should be avoided until there is designed for the public sector a financial discipline which really works, and there is equality in the cost of capital raising.

D. FINANCIAL CONTROL

1. It is clear that the next Tory Government will have to manage a sizeable public sector, even if in the long run it can be reduced. The proposals later on in this paper might result in a much larger number of units (albeit a smaller total volume) in the public sector. Further proposals are therefore put forward for managing those concerns with which our government will find itself burdened.

2. The principal instrument of control should be to set each concern a financial obligation to achieve. This obligation should be expressed as a required rate of return on capital employed. The amount of capital employed in each undertaking is, of course, arbitrary. Many industries have had capital written off, and none has updated the value of its assets to cope with inflation. Government should therefore set arbitrary capital employed figures for each concern, upon which each would be required to pay the prescribed rate of return. (The "capital employed" could be increased (or

